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INDUSTRY 2000 – NEW PERSPECTIVES*. COLLECTED BACKGROUND PAPERS.

Volume 2

INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION**.

*Issued as document ID/CONF.4/3 for the Third General Conference of UNIDO, New Delhi, India, 21 January–8 February 1980.

**This background paper has been prepared by the UNIDO Secretariat assisted by a number of consultants.

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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

INDUSTRY 2000 - NEW PERSPECTIVES
COLLECTED BACKGROUND PAPERS
VOLUME 2

INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION

Vienna, Austria

December 1979

FOREWORD

This volume presents some of the background material for the study Industry 2000 - New Perspectives published by UNIDO as ID/CONF.4/3 (Vienna 1979) for the Third General Conference of UNIDO at New Delhi, India, 21 January - 8 February 1980.

The volume contains an overview of the subject area by the UNIDO secretariat, as well as some selected consultants' papers. For the latter papers the respective authors bear full responsibility for the opinions expressed as well as for the material presented. The publication of a consultant paper must not be taken as indicating support or agreement, tacit or otherwise, with its content or form by UNIDO or its secretariat. It is hoped, however, that the publication of this documentation will make a contribution towards the understanding of problems connected with the industrialisation of developing countries.

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

INDUSTRY 2000 - NEW PERSPECTIVES

COLLECTED BACKGROUND PAPERS

INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION

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ABBREVIATIONS

The following abbreviations have been adopted:

ACP	African Caribbean and Pacific States in association with the European Economic Community
CIEC	Conference on International Economic Co-operation
CMEA	Council for Mutual Economic Assistance
CPE	Centrally Planned Economies
DAC	Development Assistance Committee of OECD
DC	Developing Countries
DEG	Development Corporation of the Federal Republic of Germany
DFI	Direct Foreign Investment
DMEC	Developed Market Economy Countries
ECE	UN Economic Commission for Europe
EEC	European Economic Community
EFTA	European Free Trade Association
FAO	Food and Agriculture Organization
FDA	Food and Drug Administration of the U.S.
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalised System of Preferences
IBRD	International Bank for Reconstruction and Development (The World Bank)
IC	Industrialised Countries (including DMEC and CPE)
ICC	International Chamber of Commerce
ICOR	Incremental Capital Output Ratio
ICPO	Investment Co-operative Programme Office (of UNIDO)
IDA	International Development Association
IFC	International Finance Corporation (of the World Bank)
ILO	International Labour Organisation
IMF	International Monetary Fund
INPADOC	International Patent Documentation Centre
INTAL	Instituto para La Integración de América Latina
INTIB	Industrial and Technological Information Bank (of UNIDO)
LDC	Least Developed Countries (according to UN definitions)
MNC	Third World Multinational Corporation
MSA	Most Seriously Affected (Countries)
MVA	Manufacturing Value Added
NIEO	New International Economic Order
NTB	Non Tariff Barrier to Trade
OAPI	African Intellectual Property Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development

OPEC	Organisation of Petroleum Exporting Countries
R + D	Research and Development
SDR	Special Drawing Rights
SELA	Servicio Latinoamericano de Cooperación Empresarial
SITC	Standard International Trade Classification
TCDC	Technical Co-operation among Developing Countries
TIES	Technical Information Exchange System (of UNIDO)
TNC	Transnational Corporation
UNCITRAL	United Nations Commission on International Trade Law
UNCSTD	United Nations Conference on Science and Technology for Development
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNIDO	United Nations Industrial Development Organisation
UNITAR	United Nations Institute for Training and Research
WIPO	World Intellectual Property Organisation

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METHODS AND MECHANISMS FOR INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION

Paper Prepared

by

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in co-operation with the
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CHAPTER 1: INTRODUCTION: METHODS AND MECHANISMS TO INSTITUTIONALIZE A COMMUNITY OF INTEREST IN INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION

1.1 The Joint Study Mandate: Methods, Mechanisms and Bilateral Guidelines for International Industrial Co-operation

Resolution 3362 of the General Assembly (S-VII of 16 September 1975) calls for a study of "methods and mechanisms" and a "general set of guidelines for bilateral industrial co-operation" geared to the specific requirements of international industrial co-operation. The following chapter will deal with the institutional, organizational and legal "methods and mechanisms" for industrial co-operation. In interpreting the mandate, it is clear that the General Assembly aimed not only at a study of existing mechanisms but also at a study of means for improving existing methods and creating new ones. This intention is reflected in the context of the Joint Study mandate - the authoritative UN Resolutions concerning the New International Economic Order [GA Res. 3201, 3202 (S-VI), 3281 (XXXIX)] and the Lima Declaration and Plan of Action (Second General Conference of UNIDO in 1975). The mandate calls for an analysis and evaluation of existing methods and mechanisms under the criteria of the General Assembly and General Conference of UNIDO and for new proposals in line with the objectives of the New International Economic Order statements. However, the wording of the Joint Study mandate also expresses clearly that the analysis of existing methods and the proposals for improved and new ones should build on those that have performed successfully. The mandate concerns "mechanisms", "methods" and "guidelines for bilateral co-operation". This is to be understood in the following sections as institutional and legal instruments to organize and to structure international co-operation in the industrial field, particularly contractual instruments to organize industrial co-operation on the micro-scale, intergovernmental agreements to organize industrial co-operation on the macro-, intergovernmental level and supportive action by competent international organizations (recommendations; mandates for support of developing countries; establishment of additional or new institutional structures; modification or revision of fundamental attitudes underlying present activities in this field).

As the following chapter is primarily concerned with legal "methods and mechanisms" for industrial co-operation, the concept of industrial co-operation needs clarifying. In the context of East/West relations, "industrial co-operation"

has been defined as "arrangements" that go beyond the sale or purchase of goods and services to include a set of complementary or reciprocally matching operations in production, in the development and transfer of technology and in marketing. These operations imply, as a rule, the creation of a community of interests between the parties extending over several years. 1/ This definition serves as a basis for the Joint Study mandate, but it must be expanded. The UN Economic Commission for Europe (ECE) definition is geared only to East/West relations, where certain, widely used forms of industrial interaction, such as foreign investment, are generally excluded. The correct approach for interpreting industrial co-operation appears to lie in the notion that a long-term community of interest has to exist between the two partners. This community of interest goes beyond a simple purchase of goods and requires considerable long-term co-ordination between the partners to achieve a common goal. The undertaking of more complex industrial operations over a longer period with vital joint action is, for the purposes of the present chapter, understood to be "industrial enterprise co-operation". 2/ This encompasses, in the North/South, East/West, East/South and South/South context, such forms of industrial interaction as the sale of industrial installations with accessory services, bi- and multipartite joint ventures, co-production, specialization and co-marketing ventures. It takes place on the intergovernmental level as on the enterprise level.

The notion of "industrial enterprise co-operation" for the purpose of the Joint Study, however, also must encompass foreign investment, a form of industrial interaction of great importance particularly in North/South relations, which is not included in the East/West notion of industrial co-operation. This inclusion of foreign investment is warranted as the evolution of new forms of foreign investment tends to converge with new types of non-equity industrial co-operation.

The Joint Study mandate emphasizes the role of "guidelines for bilateral industrial co-operation", thereby directing particular attention to analysis and evaluation of inter-governmental agreements as mechanisms for bilateral, state-to-state interaction and to proposals for their improvement. The mandate then is interpreted as a call to analyze the function and the potential of intergovernmental agreements as a means of promoting Third World industrialization and a request to study now, in the context of UNIDO, guidelines or model agreements to assist countries negotiating inter-governmental agreements for industrial co-operation.

1/ UN/ECE Analytical Report on Industrial Co-operation among ECE Countries, Sales No.: E.73.II.E.11 and ECE Doc. Trade/AC.3/R.9 of 6 August 1976;

2/ See also UNCTAD Industrial Co-operation and Collaboration Arrangements, TD/185/Supp. of 3 May 1976, at p.5.

1.2 Methods and Mechanisms to Institutionalize a Community of Interest in Industrial Co-operation: Towards a New International Industrial Development Law.

The study assumes that communities of interest exist in many fields of industrial interaction and that it is necessary to identify them and to build or provide an institutional structure to give stability to such a community of interest. 1/ The study has come to realize that the institutional forms examined not only are applicable to foreign investment, but also are relevant to all forms under which industrial enterprise co-operation takes place. The community of interest between the agents of industrial co-operation can be articulated and promoted by instruments relating to the micro-level of enterprise co-operation (contractual arrangements, bargaining assistance, corporatively structured organizational mechanisms); by instruments relating to the macro-level of industrial co-operation (particularly inter-governmental agreements); and by activities undertaken by international organizations to influence the institutional and attitudinal framework of industrial co-operation. The underlying philosophy of the chapter is that institutionalizing communities of interest fair and acceptable to both parties is, in the long run, best promoted by transforming the existing international legal framework of industrial interaction into a legal framework more balanced and acceptable to all participants. This transformation can be achieved through the long process towards a New International Legal Order for Industrial Co-operation, termed "Industrial Development Law". The methods, mechanisms and activities of International Organizations examined in the Joint Study should be viewed as steps in this process.

Community of interest is an abstract term requiring clarification. It seems that the concepts through which a community of interest can be perceived are the issues of stability and developmental performance. Stability plays a major role in the submissions of industrialized countries to UNCTAD V. 2/ Developmental performance plays the major role in the respective submissions by the Group of 77 at UNCTAD V. 3/ Stability, however, is equally relevant for developing countries, as it is a prerequisite for harnessing the developmental contribution potential of foreign enterprises and for promoting South/South co-operation. Performance is equally relevant for industrialized countries, as the evidence of effective developmental performance will ultimately be the criterion for developing countries in evaluating the utility of North/South industrial co-operation and thus be essential in their

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1/ This is in line with the interpretation agreed upon at the 1976 Eminent Persons Meeting to Discuss the Joint Study of the mandate to examine how foreign investment could be mutually advantageous and part of more equitable DC-IC relations.

2/ See a draft resolution presented by Group B countries at UNCTAD V, A Climate Favourable to Foreign Investment, Clarity and Predictability of National Investment Laws and Policies;

3/ Draft resolution on transfer of real resources to developing countries by Group 77, Private Flows Should be Fully Consistent with the Socio-Economic Priorities of Developing Countriesm Compatibility with Development Priorities of Developing Countries.

willingness to contribute towards the stability sought by ICs. It is on the basis of these concepts, and by combining them in institutionalised packages, that this study attempts to evaluate existing practices and to propose changes in existing mechanisms.

1.3 The Tool-Kit Approach: Mechanisms for Diversified Forms of Co-operation.

Methods and mechanisms for industrial co-operation cannot be applied universally. Such a goal would only result in vague and meaningless propositions familiar in the resolutions of international organizations. Accordingly, in order to produce operational, concrete and realistic proposals, the Joint Study had to aim at providing a tool-kit of diversified methods and mechanisms useful and practically applicable to some situations but rarely able to stand the test of universal applicability and acceptance. The underlying idea is that the highly diversified structure of international industrial co-operation, i.e. co-operation between East and South, West and South, South and South, between market economies and centrally planned economies and in situations of mixed economy, requires a correspondingly diversified set of methods and mechanisms. Countries should hence be free to select from this "tool-kit" the methods and mechanisms which they believe best suited for their industrial co-operation situation. This policy is rooted in the section of the Joint Study mandate suggesting that the methods and mechanisms studied should be oriented to "diversified financial and technical co-operation" and be "geared to the special and changing requirements of international industrial co-operation". This approach, which has been supported at the Meeting of Eminent Persons to Discuss the Joint Study (June 1979) attempts to avoid the impression that a comprehensive, global and mandatory system of regulation for industrial co-operation is proposed; to the contrary, the methods and mechanisms elaborated should serve as tools for individual countries. Only where an international legal framework seems essential - to counterbalance a corresponding international orientation of TNCs or to contribute to stability through methods not available on the national level - that international activities of various kinds are proposed. But even there, the proposals are directed at creating a legal framework for activities to be undertaken freely within that framework. In other words: the methods and mechanisms designed are to create a legal environment [1/] favourable to mutually advantageous and fair industrial co-operation and are not designed to force upon unwilling agents a specific course of action. They should be acceptable to market economies where the idea of a

1/ See UNCTAD TD 237, May 1979, Restructuring the Legal and Juridical Environment.

framework of economic law for enterprise operations is universally accepted in domestic and even regional operations. 1/ Some mechanisms may be more relevant for countries with planned economies wanting to achieve an institutional arrangement for specific, mutually beneficial industrial co-operation; others may apply more for market economies willing to work towards the establishment of a legal environment that encourages the stability of enterprise co-operation; still others should be particularly suited for South/South co-operation.

1.4 International Industrial Co-operation and the Relevance of National Efforts and Activities.

Third World industrialization depends only to a limited extent, it seems, on the international dimension and is conditioned predominantly by the success and performance of national efforts. However, due to its mandate, the study has to concentrate on the international dimension of industrial co-operation. But even the performance of international co-operation depends much on the efforts and performance of institutions in the developing country participating in industrial co-operation. The utility and performance of the mechanisms proposed depends primarily on the ability and the willingness of DCs to undertake energetic efforts to harness fully the developmental contribution potential of industrial co-operation. This concept of national self-reliance in international co-operation implies that the DC participant has a prime responsibility to provide the necessary stability of industrial co-operation - a factor of great importance for the success of co-operation ventures 2/, but also it has equal responsibility for organizing its administrative system to develop its bargaining capacity to the fullest. At the Meeting of Eminent Persons to Discuss the Joint Study (June 1979) it was emphasized that effective organization of administrative procedures and stability of crucial conditions of the co-operation environment are prime factors for the success of DCs in industrial co-operation. Therefore, the study has to take into account the impact of national activities related to international industrial co-operation and attempts to develop some suggestions to assist DCs interested in increasing the quality of such national activities, particularly related to improving administrative process for international co-operation and their bargaining position.

1/ See for this concept Mestmäcker, Wirtschaftsordnung und Staatsverfassung, Festschrift F. Böhm, 1975, p. 383 ff.

2/ This view has been unanimously taken by Western and by Eastern countries;

Other factors of success of industrial co-operation are rooted in the DCs' capacity to develop effective planning and programming of economic development and to place international industrial co-operation firmly within that context. The repeated emphasis on the compatibility of foreign investment with national economic development plans [1] requires that national industrial/economic development planning is able to integrate international co-operation, to lay down and to put into operation the development objectives with which industrial co-operation should be compatible. Finally, DCs have a crucial responsibility in administering effectively such development planning vis-à-vis industrial co-operation by supplying adequate regulations and by monitoring performance. These essential prerequisites for successful international industrial co-operation merit a caveat at the beginning of this study. However, a detailed study of the possibilities and methods to integrate international industrial co-operation into national economic development planning and to monitor and regulate administratively such co-operation would go beyond the scope of the present study. However, it constitutes a suitable subject for a detailed follow-up study.

1.5 The Agents of Industrial Co-operation.

The nature, the character and the behavioral pattern of the agents of international industrial co-operation have a decisive influence on its performance. DCs have a prime responsibility: to provide a legal and administrative framework geared towards stability and extracting developmental performance from foreign agents. They establish conditions and terms of industrial co-operation; they can exclude certain forms (e.g. foreign direct investment) or certain sectors (e.g. advertising; national security; telecommunications) from non-national participation; they can provide the criteria and procedures for selecting partners, types and industrial sectors for co-operation. They also have to undertake a cost/benefit analysis of the specific co-operation project at issue and to take the results of such analysis into account. DCs may encourage private business as partners for industrial co-operation and provide support; they may also - or jointly - develop capable state enterprises as organizational vehicles to set into motion a process of learning from the foreign partner.

The foreign partner - and he is necessarily foreign if the term "international co-operation" is applicable - may be transnational corporations (TNCs), state enterprises from DCs or ICs or middle-sized enterprises. TNCs are at present the by far predominant partners in industrial co-operation, be it in the context of East/West

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1/ § 42 of the Lima Declaration; § 59 (g) of the Lima Plan of Action. See also the draft resolution of the Group of 77 to UNCTAD V on the transfer of real resources to developing countries, where "consistency with the socio-economic priorities", compatibility with national legislation and development priorities of host countries is requested.

or of West/South relations. [1] TNCs are engaged in industrial co-operation through direct foreign investment [2] but also increasingly through non-equity forms of industrial co-operation. [3] This is particularly so in East/West relations where TNCs are prevented from direct foreign investment and where the terminology "industrial co-operation" originated. [4] The problems of TNC involvement in DCs are well known and are being discussed in specialized, competent fora [5] and need not be elaborated here. It is sufficient to say - and the experience of planned economies confirms this - that TNCs will certainly remain highly important actors in industrial co-operation; however, pressure for more responsive forms of TNC interaction with DCs in line with host state economic development will probably increase.

State enterprises [6] are certainly another important agent in industrial co-operation. State enterprises from Western countries, but particularly from centrally planned economies seem to participate increasingly in industrial co-operation. [7] State enterprises are also important actors in industrial co-operation among DCs. [8] Less importance is generally attached to enterprises of middle-scale, particularly from other DCs. [9] However, smaller sized enterprises and newcomer enterprises may be the most likely agents of change. They have less entrenched power positions and may be more ready to enter into innovative contractual arrangements. [10] Many

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1/ See for an extensive analysis of the role of TNCs in World Economic Relations, UN, TNCs in World Development: A Re-examination, Sales No.: E.78.II.A.5 of 1978; for issues of definition, UN Doc. E/C.10/58 of 23 March 1979;

2/ See tables on pages 228, 236 ff., in the cited UN study on TNCs, op.cit.;

3/ See UNIDO/ICIS.68 of 28 April 1978, p. 20-36 for data on the substance and the scope of non-equity industrial co-operation;

4/ See ECE Doc. R. 373 of 31 August 1978;

5/ UN Commission on TNCs, see UN study on TNCs in World Development, 1978, op.cit.;

6/ The Joint Study does not assume any position in the discussion if state enterprises can be regarded as TNCs, see UN study on TNCs, 1978 at p. 158 ff;

7/ See for some institutional issues of East/South co-operation UNIDO, Doc. ID/WG.299/1 of 2 May 1979;

8/ Cf. Zakhariya, State Petroleum Companies, Journal of World Trade Law 12, (1978) 481; UN, Petroleum Co-operation among DCs, Sales No.: E.77.II.A.3 of 1977; UN Doc. E/5985 of 24 May 1977; UNIDO has recently held an expert group meeting on the role of the public sector in DC industrialization, 14-18 May 1979 in Vienna; Mateo/White, Las Empresas Publicas Como Instrumento de Distribucion de Costos y Beneficios en un Marco de Integraction, Revista de la Integracion, vol. 16, May 1974;

9/ Cf. UNCTAD Docs. TD/244 and TD/B/C.7.17 of 18 September 1978; T. Agmon/C. Kindleberger, Multinationals from Small Countries, 1977; for an extensive analysis see the report prepared by Peter O'Brien et.al. on Direct Foreign Investment and Technology Exports among DCs, Vienna, January 1979 for the UNIDO Joint Study;

10/ See the analysis of Zakhariya for the evolution of petroleum concessions into service contracts and the role played therein by smaller enterprises, by newcomers and by state enterprises, Vanderbilt Journal of Transnational Law 9 (1976), 545 ff.

required inputs (e.g. appropriate technology, labour intensive technology) may be more ready available from foreign enterprises of medium scale and from DCs. Here, it is an issue for DC policy making and negotiating and of supportive measures by home states and international organizations 1/ to diversify the character of the agents of industrial co-operation and to promote co-operation with partners of a more manageable size and bargaining power.

Finally, home states of foreign enterprises play a not negligible and perhaps increasing role in industrial co-operation. This is certainly true in East/South co-operation 2/, but it seems also true in West/South and South/South co-operation, where home states are involved in industrial co-operation through tax regulations and treaties, by investment protection treaties and, in some projects regarded as crucial for the security of supply of natural resources 3/, directly on the enterprise level. Also, state enterprises in some Western home countries play an important role in assuring home states' interest in co-operation with DCs. The same is true for DCs, where regional integration is often crucial to industrial co-operation on the enterprise level.

The bargaining that takes place in the interaction between a DC and its enterprises and foreign enterprises and their states is explained in this study. Such bargaining is the context of industrial co-operation. Bargaining takes place more often implicitly in the case of applicable regulations and explicitly in the case of negotiations for contracts and agreements. The effectiveness of DC policies vis-à-vis foreign actors is determined primarily by its bargaining power, an inherent constraint of DC policy parameters. The analysis and the design of methods and mechanisms hence has to view policy instruments within the bargaining context. The questions to be asked are: What is the impact of a specific mechanism on the process of negotiations between a DC and its foreign partners? To what extent does it contribute towards a mutually beneficial - and not just one-sided - stability of co-operative interaction? What mechanisms minimize the costs of conflicts and lead towards optimum solutions for complex situations of bargaining? The search for long-term stability, for developmental performance and fairness should not stop at the face value of an instrument, but venture into the often complex and subtle repercussions in the DC/foreign actor negotiations. The study's proposed methods and mechanisms, grouped together as steps towards a New International Industrial Development Law can, therefore, be perceived as crucial elements of a programme to support DC bargaining for industrial co-operation. 4/

1/ See section 4 infra;

2/ Cf. UNCTAD Doc. TD/243/Supp. 1 of May 1979; UNIDO Doc. ID/WG.299/1 of 2 May 1979;

3/ See infra .

4/ Insofar, the Meeting of Eminent Persons to Discuss the Joint Study in June 1979 has emphasized the importance of tying the evolution of Industrial Development Law to an increase of Third World bargaining power and bargaining abilities.

1.5 The Evolution of the Organizational Structure of Co-operation: From Direct Foreign Investment (DFI) to Long-term Industrial Co-operation.

The traditional form of North/South interaction was direct foreign investment (DFI). It has been understood to mean investment in enterprises located in one country but effectively controlled by residents of another country. 1/ Effective control is inferred from at least 25% of ownership of the voting stock by an organized entity of residents in another country. 2/ However, this - for statistical purposes still prevailing - definition does not reflect the evolution of direct foreign investment to newer forms of investment-related interaction with foreign enterprises. The characteristic feature of all those forms replacing direct foreign investment in the traditional sense is that the equity component - the holding of stock by foreign enterprises in the operating company undertaking the investment - gives way to non-equity arrangements stipulated on a contractual basis, while control is still exercised by the foreign company through non-corporate instruments of influence. Equity is being replaced by the use of loans and suppliers' credits; direct parent control over the subsidiary by way of corporate dependency gives way to control exercised via management contracts, technicll assistance agreements, production-sharing and service contracts. Even if the corporate element is absent - which is essential for the traditional direct foreign investment definition - a corresponding control can still be exercised through tne combination of contractual arrangements and the superior bargaining power and information system of the foreign enterprise. 3/ For these reasons, reliance on the traditional concept of direct foreign investment in statistical information and particularly in foreign investment policies would entail a loss of their effectiveness to the extent they are based on an obsolete view of foreign investment. 4/ Foreign investment is also increasingly subjected to state intervention through externally operated levers. 5/ A disaggregation of the traditional type of wholly owned, wholly controlled direct foreign investment can be observed that may justify the grouping of foreign investment activities of all kinds under the umbrella of "industrial enterprise co-operation".

1/ IMF, Balance of Payments Yearbook, vol. 16, November 1964; see also UN, TNCs in World Development (1978), p. 339, op.cit.;

2/ supra, op.cit.;

3/ See background paper for the World Development Report 1979 on Private Foreign Investment in DCs, December 1978, at p. 8ff.; Wälde, Th., Transnationale Investitionsverträge, Rabels Zeitschrift 42 (1978), 28, 50ff.; Ellison, R., Management Contracts, Multinational Business 1976, March issue; Kahn, Ph., Typologie des Contrats de Transfer de la Technologie, in P. Judet et. al., Transfer de Technologie et Developpement, Paris 1977, 435ff.; UNIDO Doc. ICIS.68 of 28 April 1978, at p. 25ff;

4/ This seems to be particularly relevant for Agenda item 5 (g) of the Third General Conference of UNIDO in 1980 which is related to "foreign investment";

5/ Cf. UN, TNCs in World Development (1978) at p. 77ff, 171 ff.

Such industrial enterprise co-operation would mean a long-term and complex industrial interaction between a DC and a foreign enterprise with matching mutual performances, with some institutionalizing of a community of interests in a specific project and with the existence of a lasting interest in co-operation. 1/

The gradual replacement of direct foreign investment as relevant notion of long-term engagement of investors in DCs has also been strongly supported by the Meeting of Eminent Persons to Discuss the Joint Study in June 1979 where non-equity investment forms and long-term contracts for capital goods were said to replace traditional direct foreign investment. The advantage of using the notion of "industrial co-operation" is that it can encompass the forms of industrial interaction employed in East/West and East/South relations, where direct foreign investment through completely owned subsidiaries is mostly absent and where a functionally comparable long-term industrial co-operation through delivery of industrial plants with payment in resultant products seems to constitute a form of quasi-investment. In both cases - in the evolving forms of quasi-equity investment and in East/West, East/South co-operation - institutionalizing long-term community of interest in the establishment and the performance of industrial projects, and implicit association through substantive, organizational and procedural instruments constitutes the core of the relationship's structure. 2/

The umbrella of "industrial enterprise co-operation" allows furthermore the consideration of another important development in the organizational structure of industrial interaction: The increasing complexity of a second form of North/South interaction - the commercial transaction (e.g. purchase of equipment, licensing of patents). Packaging services and equipment has meshed with the disaggregated forms of DFI. The sale of industrial equipment and technology has been extended to include technical assistance 3/, design of industrial complexes, civil engineering and the

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1/ See also the emphasis on the establishment of a "lasting interest" in the 1978 definition of the IMF Balance of Payments Manual and the analysis of the cited background paper for the 1979 World Development Report, op.cit. at p.9;
Touscoz, J., Report submitted to the Colloquium "Les Contrats Internationaux de Co-operation Industrielle et Le Nouvel Ordre Economique International, Nice, 14-16 June 1979;

2/ One may call it "implicit association" - see contribution by Ph. Fouchard to the Nice Colloquium, op.cit. or "technological investment", see Jehl, J., La Notion d'Investissement Technologique a Travers les Contrats, in P. Judet et.al. Transfer de Technologie et Developpement, op.cit. at p. 401; one could also term it "informational investment", as the commitment of information resources seems to constitute the essence of such interaction;

3/ Salem, M., Les Contrats d'Assistance Technique, in P. Judet et.al. Transfert de Technologie et Développement, op.cit. 467ff.

organization of long-term interaction. This has been particularly the case in East/West relations where forms of industrial co-operation [1] have been designed to fulfil co-operative functions otherwise belonging to equity investment. [2] Turnkey contracts have been extended to include post-operational assistance and some measure of payment through production, with respective performance guarantees taking the place of the investor's risk in traditional foreign investment. [3] At present, we cannot yet speak of any one new type of industrial interaction, but of a process where new elements and combinations can be found. This process leads to a disintegration of the traditional legal methods of industrial interaction (i.e. direct foreign investment and commercial transaction) and to new types that integrate elements of a corporate, investment-related character and elements derived from commercial transactions (e.g. performance guarantees). Industrial enterprise co-operation appears then to be the best-suited concept to emphasize the shift away from direct foreign investment and from simple commercial transactions towards interactions with greater co-operation and co-ordination.

1.7 Operationalizing a New Concept of Performance in Industrial Co-operation Contracts.

Industrial co-operation on the project level has been defined as a long-term and complex industrial interaction between a DC and a foreign enterprise, with some institutionalization of a community of interest and an interest in extended co-operation. Consequently, we must define how industrial co-operation differs qualitatively from traditional methods of North/South interaction (direct foreign investment and commercial transaction) and in what respect these differences require a substantially different approach concerning the instruments used to organize such co-operation. "Performance" in traditional direct foreign investment means the investor maximizes profitability and the host state increases its share of the profits. In commercial transactions, the performance question is related to the price and the quality of individual items purchased according to generally accepted standards. The notion of performance of industrial co-operation is more difficult to understand and implement. For the host state, performance means an optimal contribution to national industrialization as outlined by its economic development programme. Algeria has succinctly stated this view. [4] For a foreign enterprise,

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1/ Supply of technology and complete plants in exchange for production; co-production; specialization and sub-contracting;

2/ ECE Doc. R.373, 31 August 1978; UN, TNCs in World Development (1978), p. 193ff;

3/ UNIDO Doc. ICIS.68, 1976, p. 71;
Salem, M./Sanson-Hermitte, M.A., Le Contrat Clé-en-Main et le Contrat Produit-en-Main, 1979;

4/ Annexe VI, Des Rapports de Droit entre Entreprises des Pays du Tiersmonde et Entreprises des Pays Developpés, Mémoire présenté par l'Algerie à la Conférence des Souverains et Chefs d'Etats des Pays Membres de l'OPEP, Algiers, March 1975, p. 211ff.

such a concept of performance is more difficult to follow, for it has little control over its industrialization impact on the development of a DC's economy and is rarely qualified as an agent of industrial development. How to create an effective, lasting community of interest is, therefore, the question. 1/

The purely institutional form (company) is often considered too restrictive and often infringes on some countries' economic sovereignty policies, while the purely operational form (commercial transaction) is not stable enough. Also, the corporate form will provoke intensive pressures on the host state for participation in internal decision-making, thereby escalating offensive measures (geared at national control) and defensive measures (geared towards retaining effective control while submitting formally to national control requirements). The same is true for the commercial transaction type: Host states will push for comprehensive performance guarantees as effective contributions to DC industrialization 2/ while contractors will argue for clauses protecting them against non-performance claims. 3/

Any study aimed at building an institutional structure for industrial co-operation and developmental performance should seek to avoid costs implied by such aggressive strategies The establishment of a community of interest begins with a definition of "performance". The parties' mutual expectations must be clearly expressed contractually and incentives and sanctions established on both sides. Joint actions may be undertaken in the follwoing ways:

- profit-sharing (quasi-equity organization);
- sharing of the burden of financing;
- sharing the risks and benefits of marketing;
- sharing the risks associated with the local adaptability of the technology and processes used;
- sharing the risks and benefits associated with training. 4/

1/ See generally on this the report by J. Touscoz for the 1979 Nice Colloquium, op.cit. supra;

2/ Again, the most lucid and succinct statement of this view has been forwarded by Algeria, in its 1975 submission to the OPEC conference, op.cit. supra;

3/ See the report by Benchikh, M., "Produit-en-Main" contracts, for the Joint Study;

4/ Cf. for such incentive instruments Penrose, E., Ownership and Control: Multinational Firms in less developed countries, in G. Helleiner ed. A World Divided, Cambridge, 1976, p. 147, 158ff.

The principle basic to these mechanisms aims at translating a mutually agreed upon concept of performance into criteria that allow both parties to seek high performance. Presently employed methods are no longer adquate in terms of the new concept of performance, but appropriate methods and mechanisms have yet to be developed. 1/ In addition to methods affecting the profitability calculation of the foreign partner, mechanisms of a procedural character have to be developed allowing partners to co-ordinate their performances in the face of the uncertainties and complexities of a long-term interdependence. Traditionally, the instruments of corporate organization - particularly in the form of the corporate (equity) joint venture - have provided such procedural mechanisms. If the form of company is rejected - and there may be political, symbolic and material reasons for doing so- new solutions are needed to combine purely contractual and corporate elements into a quasi-corporate organization relying exclusively on the co-operation contract. 2/ The following sections of this study will deal with specific issues where a community of interest has to be established and institutionally stabilized.

1.8 A Correlation between Types of Industrial Co-operation Contracts and Different Levels of Development.

The convergence of traditional types of industrial interaction into a new type of industrial enterprise co-operation is not yet a result but a process. It does not imply that the traditional types - direct foreign investment and commercial transaction - are no longer useful as instruments for industrial interaction. The best choice will depend on crucial factors of specific interaction and characteristics of the particular project. The general and the sectoral level of industrial development of the DC, the existence of capable state enterprises to enter into a meaningful partnership with the foreign enterprise, the capacity of the DC to

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1/ The Algerian memorandum for the 1975 OPEC Conference, however, addresses itself to one aspect necessary to put the new performance concept in operation, namely through a remuneration which is completely based on production of plants according to specified production targets, op.cit. at p. 225; however, other components making this concept workable and acceptable to foreign contractors - namely in the relationship between risk and control - have not been developed and this may be why the Algerian concept has been translated into actual contractual practice only to a very limited degree;

2/ An analysis of some co-operation contracts, e.g. in East/South relations, reveals a decision process on two dimensions: a higher level joint process, established through a firm-to-firm framework agreement or through an inter-governmental agreement ("mixed commission", "working group") and a joint decision process on the project level. It could be claimed that such a model approaches the highly sophisticated structures of joint decision-making in recent joint venture contracts in inter-enterprise co-operation, see Touscoz, J., and Fouchard, Ph., contributions to the Nice Colloquium on International Industrial Co-operation Contracts, op.cit, supra.

absorb high-level and complex technology and managerial capacities and the intensity of accelerated industrialization desired in the relevant sector are all factors that must be weighed when formulating a selective policy vis-à-vis the diversified types of industrial co-operation. Universally applicable guidelines for DC decision-making can not be developed here - the tool-kit approach excludes such a universal claim. However, it seems that for least developed countries, or sectors, it may be more appropriate to choose more traditional types of direct foreign investment and to use the levers of the investment contract to insert increasingly more and far-reaching developmental obligations. 1/ Parallel to the growth of capacities to regulate direct foreign investment and to take over - through state or private national enterprise - crucial project functions, a move towards dismantling of the direct foreign investment package (i.e. towards joint ventures and management contracts) could be considered.

DCs of an intermediate level of development might have the capabilities to engage in partly disaggregated forms of foreign investment, such as joint venture and management contracts. However, a high equity content in foreign investment may still be useful as an incentive for performance and may constitute a not negligible bargaining chip for the host state ("hostage effect"). Further disaggregation of the foreign investment structure should correspond to the establishment of sufficient national capabilities, e.g. through the development of an activist state sector or private enterprises. Joint ventures and service/management contracts should not be concluded, if their only function is to veil unrestrained control by the foreign enterprise.

DCs with a policy of tight control over access and operations of foreign industrial interaction may prefer complete unpackaging of components, i.e., not negotiating any industrial co-operation with foreign actors. This characteristic corresponds to strategies of partial delinking. It requires considerable capacities to design industrial plants and processes and to combine disaggregated foreign inputs. This strategy seems feasible particularly where a large internal market is available and where a higher degree of national self-reliance is given priority over highly accelerated industrialization through foreign inputs (e.g. India).

DCs with growing capacities and a strong emphasis on accelerated industrialization (e.g. Algeria) would seem to prefer a packaged transfer of equipment and technology, but they often reject anything close to traditional direct foreign investment. In our terms, a quasi-investment industrial enterprise co-operation is the preferred form of industrial interaction. This policy, however, assumes the availability of considerable financing capacities and willingness to assume the risks

1/ Cf. UN, TNCs in World Development (1978), op.cit., p. 77ff.

associated with non-equity investments. Here, the emphasis should be increasing efficiency and performance through appropriate performance guarantees and incentives and through procedural instruments to create and to stabilize a workable community of interest.

Finally, developing countries of a relatively high level of industrial development may, within the constraints of their economic system, be able to operate effectively with most types of industrial co-operation although they may restrict packaged forms (from direct foreign investment to turnkey projects) generally or in specific sectors (e.g. Japan). Here, much depends on the extent to which a developing country is willing to be integrated in the prevailing world economic system. Reluctance to accept complete integration would seem to imply a strong emphasis on screening and reducing industrial co-operation packages, particularly in sectors vital for industrialization.

No framework can exist for the evaluation of the diversified forms of industrial co-operation. Much depends on the individual industrial sectors. Also, developing countries will have considerable scope to experiment and to diversify the types of industrial co-operation as agents of industrial co-operation also diversify. Finally, more important than the general structural type of contract is the individual regulation of major functions of industrial investment co-operation, i.e. management and control, performance, marketing, stability, incentives, linkages, remuneration and financing through internal or external instruments. The evaluation of presently employed methods and mechanisms and the design of new ones to improve the developmental quality and performance of each contractual type will be the focus of the following sections of this study.

CHAPTER 2: GUIDING CONCEPTS

The evaluation of existing methods and of new proposals has to rely on a set of criteria which follow, for the purpose of this study, the guidelines set forward by the UN General Assembly in its authoritative resolutions relating to a New International Economic Order. These guiding concepts assume that DCs have to assert their authority over the terms and conditions on which industrial co-operation is undertaken within their national economies. They are insofar an expression of the principle of national economic sovereignty. 1/

The guiding principles assume that DCs have to counteract the effect of a non-national control over their national economies - often effected through TNCs - by insisting that industrial co-operation is tailored to the national industrial development strategy. As the DCs' partners in industrial co-operation, particularly TNCs, operate on a global scale, the countervailing strategy often cannot limit itself to national controls, but must seek to provide a mechanism whereby the national sovereignty of DCs is articulated on a regional or even on a global scale. The guiding concepts outlined below are inter-related, but express distinct aspects of Third World industrialization through international industrial co-operation with the view of bringing about a New International Economic Order. The guiding principles are crucial elements of a New International Industrial Development Law, which is to be understood as the legal dimension for a New International Economic Order.

2.1 Interdependence through Mutual and Long-term Benefits: The Quid-pro-quo Package Approach and the Principle of Home and Host State Co-responsibility.

The long-term stability of development in the world economic system requires the substitution of present unilateral dependencies of many DCs by a network of interdependence. Such interdependence is best achieved and maintained when it works to the benefit of all partners. Therefore, new legal mechanisms have to attempt to organize structures of co-operation which, in the long run, generate visible benefits for all sides concerned. Communities of interests are found often and can frequently extend over a period of time and increase in scope. However, the given instability of the environmental factors and the perception of uncertainty prevalent require such communities of interest to be institutionalized. Legal instruments certainly cannot create a community of interest, but they can help extend an existing community of interest and enable it to weather the unavoidable storms of changes. We have hence to find areas where community of interests can exist and provide these with an organizational framework for the stabilization of such situations.

1/ For a discussion of these questions see: Bedjaoui, Pour un Nouvel Ordre Economique International, 1979.

The guiding concept of institutionalized interdependence means that mechanisms have to be sought out that could package interests vital to both participants. To the extent feasible, individual mechanisms should provide a quid-pro-quo negotiating package. Sometimes, however, the quid-pro-quo negotiating package must constitute a combination of mechanisms. Some of the instruments evaluated are more oriented towards DCs (e.g. performance mechanisms) while others (e.g. stability mechanisms) seem to be more oriented towards ICs. However, a careful analysis will often reveal that many issues traditionally claimed by ICs (e.g. stability) are equally important to DCs (particularly in the South/South context) and that issues claimed by DCs (e.g. control of TNCs) could be equally of interest to ICs.

The guiding concept of seeking to institutionalize an interdependence in industrial co-operation is by no means limited to the micro-level of interaction: Also on the macro-level (state-to-state interaction), communities of interest can be sought out and an inter-state interdependence can be institutionalized. In the present study, this applies particularly to the principle of co-responsibility of home and host states to industrial co-operation. At present, home state responsibility for industrial co-operation is only assumed by socialist countries because of their economic system.

Industrialized market economy countries are not ready to assume full responsibility for the operations of their enterprises in DCs. They claim that these enterprises are autonomous agents. However, home states of TNCs become involved through inter-governmental investment protection treaties and through diplomatic intervention. Through taxation, they receive their share of revenues generated by foreign investment in DCs. Mechanisms for industrial co-operation should seek ways to involve IC governments in some form of co-responsibility, which is more than an expression of defensive attitudes. It is assumed that market economy ICs have to encourage their enterprises operating in DCs to implement some measure of co-responsibility in performance and regulation. On the other hand, DCs would have to assume co-responsibility for the environmental conditions of industrial co-operation they can control. The study envisages package deals where home state co-responsibility for enterprise performance is combined with a balanced system of conflict resolution and assurances relating to ICs vital interests concerning industrial interaction with DCs.

2.2 Counteracting Unequal Development.

Many of the legal instruments employed at present in industrial co-operation express the needs of traditional commercial interaction between industrialized countries or the unequal economic relationship between ICs and DCs. In that context, they are primarily geared to protect the interests of TNCs and capital-and technology-exporting countries. They tend to perpetuate unilateral dependence and unequal development. In conflict and bargaining situations the influence of such traditional

legal instruments is likely to favour ICs and TNCs, reflecting a systemic bias towards the modes of business operations prevalent among TNCs. The history of international arbitration in investment disputes between TNCs and DCs supports this assumption. Accordingly, legal instruments on the micro- and on the macro-level have to be elaborated to counteract unequal development. This means generating legal mechanisms which not only imitate concepts and instruments growing out of IC interaction, but also express the specific needs and objectives of DCs. The North/South transfer of legal concepts, instruments and techniques - through institutions, training and negotiation - has to be complemented or substituted, by the generation of alternative legal concepts in the South/South context. The development for new legal concepts for governing industrial co-operation [1] is one avenue for the establishment of a New International Information Order. [2]

Concretely, this may imply positive discrimination as a remedy for de facto unequal situations. This applies particularly to the crucial legal instrument of contract. The recognition of the contractual form is based on the assumption of equality of the contracting partners. As this assumption is, in the transnational context often invalid, compensatory mechanisms have to be developed to achieve material equality. [3] This is by no means a revolutionary concept. For a long time industrialized countries have established mechanisms to compensate for unequal bargaining situations and to protect the weaker party. It is only suggested here that this principle be applied in the international context as well. [4]

2.3 Increase of Developmental Performance and Efficiency.

Most types of legal instruments used in industrial co-operation are derived from intra- or inter-IC commercial interaction or oriented at investment protection. The specific problems of co-operation with DCs and their considerably greater vulnerability to non-performance requires protective instruments yet to be developed into workable and mutually acceptable mechanisms. [5]

Performance is understood as the contribution of industrial co-operation to DC industrial development. This study analyses existing methods with this objective in mind and with the aim to increase the ability to promote developmental performance

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1/ The Algerian submission to the 1975 OPEC Conference, op.cit.;

2/ Cf. the contributions to the Deuxieme Colloque de l'AFETIMON, l'Information et le Tiers-Monde, Dijon, 30 May - 1 June 1979;

3/ See Weber, H., Der Anspruch auf Entwicklungshilfe, in Verfassung und Recht in Übersee, 1978, p. 5ff.;

4/ Cf. Kroppholler, Das kollisionsrechtliche System des Schutzes der schwächeren Vertragspartei, Rabels Zeitschrift 42 (1978), p. 634ff.;

5/ This applies for many of the proposals put forward by Algeria, see submission to the 1975 OPEC Conference, op.cit.

and efficiency simultaneously. The approach is not to effect a North/South transfer of existing instruments, but to look at the problems DCs face in industrial co-operation and then to seek out methods that might provide solutions and be mutually acceptable. Performance can be promoted by developing new legal instruments at the micro-level of industrial enterprise co-operation which take into account the DC sensitivity of DCs due to their less developed industrial infrastructure (e.g. extended guarantees). It can also be encouraged by instruments that allow a more extensive commitment of the foreign enterprise to host state industrialization, such as host state offers of greater efficiency and reliability and more effective performance incentives. Finally, the home state can be involved in the project's success by using inter-governmental co-operation agreements to institutionalize its co-responsibility (e.g. joint project and enterprise selection; assumption of liability for mal-performance).

2.4 Improvement of Third World Bargaining Abilities.

Industrial co-operation and its effects on DCs are determined to a considerable degree in the bargaining undertaken by DCs, foreign enterprises and ICs. Achieving industrialization objectives through industrial co-operation depends to a large extent on the ability of DCs to expand and to exploit their bargaining power and their bargaining abilities, be it through individual or through joint action. 1/ Methods for industrial co-operation must be analyzed and evaluated within the context of bargaining. One improvement would be to diversify the forms and agents of industrial co-operation. Traditional partners and traditional forms - such as TNCs and DFI - should be complemented by unpackaging of investment packages and by access opportunities created for state enterprises and middle-sized industry. Increasing bargaining abilities implies a careful evaluation of alternative partners with regard to their ability and willingness to contribute effectively to DC industrial development.

Another dimension would be to assist DCs to organize their internal negotiating and administrative systems more effectively. As has been noted 2/, self-reliance in bargaining would imply internal co-ordination, information-sharing and effective administration. Stability resulting from such effective administrative structures might become a most effective bargaining asset of DCs. A third dimension would be directed at bargaining co-operation among DCs. Here, much can be learned from the strategies employed by TNCs. In contrast to often publicized models of free

1/ Cf. § 48 of the Lima Declaration;

2/ Meeting of Eminent Persons to Discuss the Joint Study, Vienna, June 1979.

competition, we find highly sophisticated techniques of gaining control over world markets through mechanisms of information-sharing and co-ordination action, often with home-state support.

Improving Third World bargaining abilities aims at increasing the legal and organizational skills available in DCs. However, this may apply less to more developed DCs, which have accumulated considerable bargaining skills, but much more to the less developed countries. Here, a co-operation between DCs of a different level of bargaining abilities might be an avenue of action. However, it is not only through provision of legal and negotiating skills that Third World bargaining abilities could be improved, but also by compensating DCs for their often highly inferior ability to obtain and use information. 1/

International organizations for collection, dissemination and use of information for bargaining purposes could expand their activities among DCs. Bargaining assistance is at present undertaken by several international organizations. It is certainly necessary to build upon activities already existing or in project stage, an evaluation of their effectiveness in actual negotiation situations and of the basic concepts and attitudes underlying such assistance is warranted. This may lead to a re-thinking of such attitudes. The bargaining context is relevant for mechanisms governing specific co-operation projects, but the evolution of a new International Industrial Development Law cannot be ignored. The present international legal framework considerably favours bargaining strategies employed by TNCs, directly through the application of traditional international law in international arbitration and indirectly as DCs have come to expect such action or their negotiators are influenced by the systemic and cultural biases of ICs. The increase of developmental performance of industrial co-operation is, therefore, linked inextricably with improved Third World bargaining abilities.

2.5 Stability through Arrangements that Promote Stability and Flexibility at the Same Time.

It is generally recognized that stability and reliability of the co-operation environment and of the terms and conditions are prerequisites to the development of industrial co-operation. On the other hand, unequal bargaining power and the instability of the social, economic and political environment of DCs and of their position in the world economic system adds to the perception of uncertainty and risks. This, in turn, results in mutually expensive and unproductive defensive

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1/ Cf. O'Brien, Cruise, Contribution to the Second AFETIMON Colloquium in Dijon, May/June 1979.

strategies. In the international debate, ICs insist vigorously on "investment security" while DCs call for priority for "national sovereignty". The study assumes that investment security is not simply rigidly tying the hands of a country engaged in rapid economic and social transition and vulnerable to the controlling vagaries of international markets and TNCs' strategies. To the contrary, it is necessary to search for instruments that are flexible enough to respond to DCs' developmental needs and that provide, at the same time, sufficient predictability for risky industrial commitments. Certainly, such instruments can do little to avoid destabilizing events over which neither party has sufficient control, but they can at least help to reduce costly defense strategies and the risk perception with its corresponding risk management costs. The study will seek to elaborate and employ a concept of "dynamic stability", i.e. a synthesis of necessary stability with requisite responsiveness. Innovative mechanisms designed in accordance with that concept should allow for long-term planning and co-ordination. Systems of adaptation should allow reduction of costs created by conflicts arising between insistence on the immutability of terms and demands for fundamental revisions of conditions once negotiated.

CHAPTER 3: ISSUES AND MECHANISMS OF INDUSTRIAL CO-OPERATION

3.1 From Traditional International Law to International Industrial Development Law.

3.1.1 Evaluation of the Present Legal Environment for Industrial Co-operation.

International industrial co-operation takes place within the framework of international economic law. Rules derived from that legal framework often may not be directly applicable to co-operation projects: they are generally too vague and directed primarily to inter-state relationships. However, the standards of behaviour expressed in international law exercise a considerable impact on negotiations for the undertaking, the implementation and the revision of co-operation projects. They lay down standards of behaviour of states vis-à-vis foreign investors, they provide for legitimacy for sanctions against DCs transgressing such standards. They also shift the burden of proving the legitimacy of action to DCs. Even if not always directly applicable, they are ever present, ready to be invoked and thus to restrain the scope for action by DCs vis-à-vis TNCs. Also, concepts in international law often influence the content of specific investment contracts and regulations through referral or through direct incorporation.

International economic law is - though its origin as the common international law of the Western nations - geared towards regulating commercial interaction between ICs. More recently, it has been directed specifically at protecting the interests of capital- and technology-exporting countries. Its defensive orientation creates substantial obstacles for DCs attempting to develop their economic sovereignty and to render foreign investment more responsive to the requirements of the process of industrial development. 1/

These "roadblock" effects of traditional international law have surfaced visibly in major cases of international arbitration where DCs' attempts to revise investment agreements were at issue. 2/ The standards of compensation required for nationalisation under international law ("prompt, fair and adequate") have blocked many attempts to exercise the recognized sovereignty over natural resources and economic policy in a meaningful way. 3/ The same can be said of bilateral investment

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1/ See for an extensive explanation of these issues Bedjaoui, Pour un Nouvel Ordre Economique International, UNESCO, 1979; Friedman, W., The Changing Structure of International Law, 1964;

2/ Wälde, Th., Negotiating for Dispute Settlement, Denver Journal of International Law and Policy, 7 (1977) 33; Benchikh, Report for the Joint Study, op.cit.;

3/ Cf. Girvan, N., Corporate Imperialism, New York, 1976.

protection treaties. These treaties are often concluded in the context of unequal bargaining power. Assuming a formal equality ("both parties commit themselves to protect each others' investments"), they grant material privileges to foreign investment by industrialized countries without a corresponding commitment of the IC in respect to performance or control. 1/

The traditional legal framework of industrial interaction expresses primarily a defensive position: it demands "investment security" from DCs without taking account of the conditions for stability in DCs. Because it does not provide instruments for the real problems of North/South industrial co-operation (such as adapting legal instruments to a fast transition or designing mechanisms to achieve performance under DCs' specific conditions and international control of TNC activities) traditional international law defeats its own purpose: it does not contribute to long-term stability of industrial co-operation. To the contrary, it leads to the absence of a universally accepted international framework for industrial co-operation in the face of competing claims for globally valid juridical concepts. Defensive measures in favour of rigidly protected investment terms and offensive measures in favour of development policies escalate into mutually costly conflicts.

Accordingly, a new legal framework for industrial co-operation - the legal dimension of the New International Economic Order - is warranted. Such a system has to be acceptable to all members of the international community. The legal system can no longer tenaciously defend the position of the industrialized market economy countries, but must respond to the developmental needs and constraints of DCs. The argument is often advanced that a new system of international economic law should be tilted unilaterally in favour of DCs 2/ in order to compensate the Third World for past discrimination and exploitation. 3/ This need not be so: Universal recognition of a legal framework for industrial co-operation will only be possible if the framework promises to be of advantage to all parties concerned - ICs and DCs included. The concepts of interdependence and ultrastability elaborated imply that benefits for both sides can be maximized if a pattern of stability in development can be achieved. Such "dynamic stability" is best achieved in a legal environment which accommodates requirements of stability and of evolution. It is not the defensive orientation which will bring about investment stability, but a positive, active and dynamic orientation.

1/ Hartmann, G., Nationalisierung und Enteignung im Völkerrecht, 1977;

2/ Agrawala, S.K., Indian Journal of International Law, 17 (1977) 261; Girvan, N., Corporate Imperialism, p. 180 ff;

3/ Leitolf, A., Völkerrechtliche Aspekte der Echeverria Doktrin, Blätter für deutsche und internationale Politik, 1976, 166 ff.

The objective of policies to transform traditional international law must hence be the creation of a legal and institutional environment [1] which expresses a balanced, ultrastable and mutually advantageous interdependence. Such a system of international law promises that DC concerns will be recognized in a more effective way than through non-mandatory resolutions; it promises ICs a truly universally recognized - though fundamentally revised - system of international law. Both effects are necessary for stability in development advantageous for all participants in industrial co-operation. It should gradually overcome the present fragmentation of legal systems which claim universal validity, but are in fact but an expression of the prevailing attitudes of distinct groups of countries. It is certain that each legal system aspiring to universal validity has to make substantive concessions to achieve universal recognition. But it is also true that the much sought stability will be most fostered if a process of consensus-making on the global level is successful. Such a new legal system for industrial co-operation will be termed "International Industrial Development Law". [2]

Many of the concepts guiding the evolution of an international industrial development law have been expressed by the authoritative resolutions relating to a New International Economic Order (NIEO) (UN GA resolution 3201, 3202 and 3281; the Lima Declaration and Plan of Action). [3] These resolutions often express already accepted elements of a new international legal environment, particularly to the extent that there has been unanimous consent. In these areas, the task is to implement, to draw conclusions applicable to industrial co-operation and to develop further the rather broad new principles already articulated. A process establishing a new international legal environment for industrial co-operation under the umbrella of the NIEO concepts must be set in motion. To some extent, a new consensus has not yet evolved, as major ICs have not consented to several crucial positions in the NIEO statements. [4] Here, the question is how to evaluate the impact of the NIEO. The absence of consensus may not completely eliminate the impact of the respective NIEO statements; even if a new legal framework has not yet evolved, the traditional international law can no longer be considered universally valid and binding for the majority of countries have solemnly enunciated an alternative concept. Insofar, one can speak instead of a positive law-making effect, of a negative effect of authoritative UN

1/ See for the emphasis on the legal environment for the effectiveness of the transfer of technology policies UNCTAD Doc. TD/237, May 1979;

2/ See for a discussion of this issue Friedman, W., Changing Structures of International Law, 1964; Petersmann, E.U., Völkerrecht und Entwicklung, Verfassung und Recht in Übersee, 1972, 161; Schachter, O., The Evolving Law of Development, vol. 15, Journal for Transnational Law 1 (1976); El-Kosheiri, Stabilité et Evolution dans les Techniques Utilisées par les Pays en Voie d'Industrialisation, in: Le Contrat Economique International, 1975, 285; Virally, M., Vers un Droit International de Développement, Annuaire Français de Droit International, 1965, 3; Agrawala, op.cit.; Bedjaoui, M., Pour un Nouvel Ordre Economique International, op.cit.;

3/ See for an analysis of the relevance of these resolutions Agrawala, op.cit.;

4/ See for an analysis Agrawala, op.cit.; Kemper, R., Nationale Verfügung über natürliche Ressourcen und die Neue Weltwirtschaftsordnung der Vereinten Nationen, 1976, p. 60ff, 73f.

resolutions. The result is a legal vacuum where no universally valid rule exists, i.e. where traditional international law has lost its universal validity, while a new legal system has not yet evolved fully. 1/ This vacuum challenges the international community, as the existence of a universally recognized legal environment can contribute considerably towards mutual, long-term benefits from industrial co-operation. It is here that a gradual process of consensus-building - on regional and global levels - has to be promoted by existing and by new mechanisms and institutional arrangements.

The directions for the evolution of international industrial development law may be - in line with the authoritative NIEO resolutions - the following:

(i) the principle of national sovereignty over industrial development.

This principle is closely related to permanent sovereignty over natural resources, of national control and jurisdiction over TNCs' operations and to the respect required of TNCs for national economic development policies; 2/

(ii) the principle of stability of contractual commitments related to industrial co-operation. The positive contribution from industrial co-operation can only then be exploited fully if the degree of stability necessary for long-term commitment of risk capital, technology and managerial capacity is ensured. This would, however, not imply a rigidity of long-term contracts as postulated in the strict investment security concept; 3/

(iii) the principle of positive discrimination in favour of DCs.

In order to correct the unbalanced and unequal development of DCs, the legal environment must recognize positive discrimination or "affirmative action" as legitimate and provide respective instruments in favour of DCs' industrialization policies. One aspect of this principle is the privileged treatment which should be accorded to South/South industrial co-operation to correct the present unbalanced predominance of North/South interaction. This concept is well known also in the internal exploitation of economic and social law in ICs;

1/ For the derogatory effect of authoritative UN resolutions cf. Castaneda, Annuaire Français de Droit International, 1974, p. 56; Virally, ibidem, 1974, p. 58f.; Petersmann, Internationales Recht und Neue Internationale Wirtschaftsordnung, in: Archiv des Völkerrechts (1978), 17, 38;

2/ These inferences can be drawn from the ongoing discussions for a Code of Conduct for TNCs; see UNCTC Docs. E/C.10/17 and E/C.10/18 of 1976/1977; E/C.10/AC.2/9 of 22 December 1978;

3/ Cf. Sornaraja, Journal of World Trade Law, 1979, 108ff.

(iv) the principle of collective bargaining.

Collective action is undertaken on an increasing scale by TNCs and by groups of DCs (OPEC) and ICs (OECD; EC). In the decision process of the UN, collective bargaining is already the predominant mode of interaction. In order to compensate for unequal bargaining power of DCs vis-à-vis ICs and TNCs, collective bargaining should be increasingly used on a scale where it is feasible, e.g. by groupings of commodity producers 1/ or on a regional level. Institutional mechanisms to organize collective bargaining should be promoted (§ 48 of the Lima Declaration). It is also necessary to increase the efficiency of international, multi-state negotiations;

(v) international regulations of industrial enterprise co-operation.

Finally, there is one important feature of the international legal environment for industrial co-operation: the need for some scope and authority for regulation on the international level. It is generally stated in authoritative NIEO statements 2/ that supervision and regulation of TNCs is required to "ensure that these activities are compatible with the development plans and policies of host countries, taking into account relevant international codes of conduct and other instruments" (§ 42 of the Lima Declaration). As long as regulation at the national level is sufficient to obtain this objective, there is no need for international action with the exception of international recommendations and supportive action. To the extent, however, that TNCs operate on a global scale and that national action alone is not sufficient to provide a countervailing regulatory function, regulation on the international level is necessary. This may mean regulation on the regional or global level, depending on the need to countervail the respective strategies and structures of TNCs. The emphasis on national sovereignty is hence first to assert and to maintain the authority of public decision-making over the economic processes dynamically engineered by the TNCs. In addition, there is a need to complement the national sovereignty approach by strategies expressing the political sovereignty of the community of states on the international level.

3.1.2

Methods and Mechanisms.

The process towards a new international industrial development law for industrial co-operation requires considerable national and international effort. One instrument to promote the evolution of a new legal environment for industrial co-operation is the

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1/ See the analysis of the Joint Study chapter on mineral processing;

2/ See GA Resolution 3201 (S-VII), Art. 4 (4); GA Resolution 3281 (XXIX), Art. 2.

increased and innovative use of inter-governmental agreements. In the case of bilateral agreements, such methods generate international law for industrial enterprise co-operation between two countries, often applicable only to specific sectors and to specific forms of co-operation. At present, international law does mostly not contain rules precise and detailed enough to solve many problems encountered in North/South co-operation. Here, inter-governmental agreements gradually can elaborate specific and appropriate rules. Socialist countries have for some time employed intergovernmental agreements, be it in the context of CMEA or in East/South relations, as a method to generate a specific set of rules for industrial co-operation. 1/ This approach to generating a new international legal environment - be it on a bilateral or multilateral basis - will be expanded in the following section.

Another method is the development of improved and new contractual instruments for industrial enterprise co-operation. A new body of law develops not only through state-issued law, but also to a considerable degree through contractual practice. Innovations and improvements in this practice help evolve a new legal environment. It is here that the elaboration of model contracts and contracting guidelines and of international recommendations for contractual practice have to be viewed as steps in the evolution of law. The model contracts and guidelines as elaborated particularly under the auspices of UNIDO, 2/ the UN Economic Commission for Europe 3/ and UNCTAD 4/ belong into this pattern as does the work of UNCITRAL which is directed at the uniformisation of international trade law and trade practices. 5/

1/ See on the process of evolution of a regionally limited international industrial co-operation law in the CMEA case Seiffert, W., Sozialistische ökonomische Integration - Rechtsfragen, 1974, p. 11; Boguslavskij, M.M., Aktuelle Rechtsfragen der Wirtschaftsbeziehungen sozialistischer Länder, 1973, p. 33ff;

2/ See Manuals on Industrial Joint Venture Agreements, E.71.II.B.23; Guide to Industrial Purchasing, E.72.II.B.19; Manual on the Use of Consultants in Developing Countries, E.72.II.B.10; Subcontracting for Modernizing Economies, E.74.II.B.12; Contract Planning and Organisation, E.74.II.B.4; Guidelines for Contracting for Industrial Projects in Developing Countries, E.75.II.B.3. At present, UNIDO is engaged to a considerable extent in the elaboration of model contracts for the fertilizer industry in developing countries and of contracting guidelines for the transfer of technology;

3/ E.g. Guide for Use in Drawing up Contracts Relating to the International Transfer of Know-how in the Engineering Industry, E.70.II.E.15; Guide on Drawing up Contracts for Large Industrial Works, E.73.II.E.13; Analytical Report on Industrial Co-operation among ECE Countries, E.73.II.E.11; Guide on Drawing up International Contracts on Industrial Co-operation, E.76.II.E.14; see also various general conditions relating to plant and machinery drawn up; for supply of plant and machinery for export (ME/188/53), for supply and erection of plant and machinery for import and export (57.II.E/Mim.3); for the erection of plant and machinery abroad (57.II.e/Mim.3); see for further references the Guide on Drawing up International Contracts on Industrial Co-operation, op.cit. p. 27;

4/ International Subcontracting Arrangements in Electronics between Developed Market Economy Countries and Developing Countries, E.75.II.D.17;

5/ See the annually published Yearbook on International Trade Law.

To some extent, the trend is away from international conventions to model contracts and contracting guidelines, a considerably less expensive way of international legal harmonization. The following sections of this study will elaborate issues of industrial enterprise co-operation contracts where considerable improvements towards an International Industrial Development Law can be expected.

Another source for the evolution of the legal environment for industrial co-operation is the decisions handed down by courts - primarily national courts - and by arbitration tribunals. Arbitration tribunals are viewed with great scepticism by many developing countries 1/, particularly in most Latin American countries, where international arbitration is often equated with non-national domination affecting national sovereignty. This reluctance is also directed to all well known international institutions for arbitration, such as the International Chamber of Commerce (ICC), the International Court of Arbitration or the World Bank's International Centre for Settlement of Investment Disputes (ICSID). The latter has been seen by investors as an instrument to protect their investment against nationalization and renegotation 2/ and has been correspondingly viewed critically by some developing countries. However, if international arbitration is undertaken by institutions where Third World concerns find a proper articulation, it can become a powerful mechanism for promoting the evolution of a new International Industrial Development Law. The issue for developing countries seems to be not defense against international arbitration, but how to employ it to create a new international legal order and to integrate it into the process towards an appropriate legal system for industrial co-operation. 3/

Another method of developing a new legal system for industrial co-operation is the design of Codes of Conduct affecting industrial co-operation, particularly on TNCs and on Transfer of Technology. 4/ Global Codes of Conduct will probably not be able to state detailed obligations directly affecting industrial co-operation. Often, they will lag behind national foreign investment regulations of several advanced developing countries. However, negotiations for Codes of Conduct and the experience generated will have a persuasive effect on the evolution of industrial

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1/ See the report by Benchikh, M., op.cit. for the Joint Study;

2/ See the comments by Schmidt, J., on the case of ALCOA vs. the Government of Jamaica, Harvard International Law Journal 17 (1976) 90;

3/ Cf. Fouchard, Ph., Arbitrage et Droit International du Développement, in Actes du Colloque International Tenu à Alger du 11 au 14 Octobre 1976, p. 477; Bedjaoui, M., Recueil des Courts de l'Académie du Droit International, 1970, II., P. 532 seems to support this attitude when he calls for the generation of new legal concepts and of processes for developing them;

4/ Cf. Baade, H., Codes of Conduct for Multinational Enterprises, paper for the Bielefeld Symposium on Codes of Conduct, July 1979,

co-operation law on levels already discussed. It may be that more detailed conventions on individual matters [1] could implement a Code of Conduct once negotiated and that a permanent implementation machinery could help evolve, under the umbrella of a negotiated multilateral convention, new legal rules for industrial co-operation. The same could apply to corresponding instruments on the regional level, where, because of greater homogenity, a consensus might be reached on a more concrete level. [2]

All these avenues, from the privately generated lex mercatoria of contractual practices to Codes of Conduct negotiated by sovereign states, contribute to the evolution of a new Industrial Development Law. However, there seems to be a relative absence of international bodies to serve as forum and as catalyst for opinion-building, information-sharing, negotating and co-ordinating. Existing institutions - programmes of international law, conferences, publications, institutes - are heavily influenced by legal experts from ICs or having been trained in ICs legal tradition. Developing countries have less potential and fewer resources to develop, to co-ordinate and to advocate their alternative legal concepts. The present information system in international law is geared, as in other areas, towards a North/South transfer of information and scarcely functions in a South/South or South/North direction. [3] Academic dependence and the absence of institutionalized mechanisms for communication and opinion-building contribute to this situation. [4]

Accordingly, global and regional international organisations should be responsible for providing countervailing institutional mechanisms. These institutional arrangements should be oriented towards developing and supplying concrete substance and argument to alternative legal concepts, based on authoritative NIEO resolutions; collecting, analysing, disseminating and evaluating relevant information on the international practice of industrial contracting; [5] and assisting negotiations by providing guidelines, recommendations and multilateral conventions in the area of International Industrial Development Law. The task should also comprise the re-orientation of existing arbitration procedures and the establishment of new ones to work towards the evolution of a new law for industrial co-operation.

1/ E.g. corrupt practices and illicit payments; transfer pricing; tax operations; accounting practices;

2/ E.g. the rules on foreign investment and transfer of technology issued by the Andean Pact Institutions, see Danino, R., The Andean Code after Five Years, 8 Law Am. 635 (1976);

3/ With some exceptions, e.g. the Asian-African Legal Consultative Committee;

4/ See generally the Deuxieme Colloque de l'AFETIMON, Dijon, May/June 1979 for this issue;

5/ The private lex mercatoria, see Kahn, Ph., Lex Mercatoria et Pratique des Contrats Internationaux, Travaux des 7es Journées d'Etudes Juridique, Dabin, J., Paris, 1975, p. 171.

Among existing institutions, the UN Commission on International Trade Law (UNCITRAL) has a related task, but it is primarily oriented at the unification of commercial law issues. It also seems that Third World industrialization and the legal dimension of the NIEO are not a priority concern for UNCITRAL. 1/ The apparent self-limitation by UNCITRAL and growing complexity of industrial co-operation and increased importance of industrialization goals over mere trade-transaction-goals would seem to require a new, forward-looking institutional body with the courage and expertise to take part in shaping a new International Industrial Development Law. Such a body should certainly co-operate closely with other UN organisations dealing with legal issues of the NIEO - UNCITRAL, WIPO, UNCTAD, UNESCO. It would seem that the placing of all these rather disjointed activities in one institutional setting under the common goal of promoting Third World industrialization has distinct advantages. The goal could be reached by re-orienting present subsystems of the UN system. However, none seems at present to have the necessary concentration on Third World industrialization or to be likely to adopt such an orientation in the near future. The creation of a new institution seems warranted.

Our proposal is to establish a Commission on International Industrial Development Law (CIDEL). It should consist of eminent exports in legal issues of industrial co-operation, primarily in the North/South and South/South context. It appears preferrable not to give a primarily political orientation to such a body, which would be done through an intergovernmental structure. Such an orientation is more likely to inhibit innovation and to strengthen natural tendencies of lawyers who prefer established patterns. The concept of a permanent body of "Eminent Industrial Co-operation Lawyers" may be more useful. The Commission would meet periodically to supervise, evaluate and direct legal activities as outlined in this study. Its main mandate would be to promote the evolution of a legal environment for industrial co-operation responsive to the goals of Third World industrialization. A highly qualified secretariat group for industrial development law would have to be established. One could thus remedy a deficiency of the UN secretariat to assist the Commission carry out its functions and to co-ordinate with other competent UN organizations. Its tasks would be primarily:

- design of contracting guidelines, model contracts and manuals, in co-operation with other competent bodies in the global UN system (e.g. UNCITRAL, UNCTAD, CTC, UNIDO system of consultations and the Regional Economic Commissions;
- provision of negotiating assistance to developing countries (an UN development law firm);

1/ The Secretariat Doc. A/CN.9/171 of 2 May 1979, at p. 22 is rather explicit that such issues "are to a great extent of a political and economic nature and cannot be dealt with by a legal body such as the Commission".

- preparation and co-ordination of proposals for legal harmonization in the area of industrial co-operation (infra section 12);
- issue studies on evolving legal issues of industrial co-operation to present alternative concepts and evaluate existing practices;
- organize workshops and seminars to train legal experts from developing countries. Here, co-operation and a respective orientation of the UN university system and the UNITAR research system seems highly useful. The basic idea should be to offer future developing countries' experts and leaders a countervailing institutional alternative to the high-level legal education offered at the leading universities of industrialized countries; 1/
- participate and act as a co-ordinating centre for formal and informal systems of information-sharing and opinion-building among developing countries;
- supervision and co-ordination of the proposed System for the Resolution of Industrial Conflicts (SRIC).

The proposed Commission and its Secretariat could function as the main supervisory body for the proposed programme to generate bargaining technology and new contractual mechanisms for industrial co-operation. It could also be charged with drawing up organizational statutes for legal entities which may be brought up from the various functional areas of the Joint Study. Furthermore, the Commission could consider the establishment of alternative patent and trademark regulations mentioned in the technology section of the Joint Study, in co-operation with other competent UN bodies.

It is not our task here to propose detailed organizational structures. One possibility would be to set it up as a separate organ under the UNIDO General Conference or the IDB in line with Article 7 of the proposed UNIDO constitution. Another would be to set up a Permanent Body of Eminent Lawyers as an advisory body to the Executive Director of UNIDO. Also, co-operative structures with other UN organizations - such as UNCITRAL which has been transferred to Vienna - could be envisaged. However, care should be taken that the composition and functions of the Commission and the Secretariat promote the evolution of a New International Development Law.

1/ To counteract the subtle techniques of integrating intelectually the future elites of developing countries (Cf. Faver, T., Foreign Policy, 1976, 1979, The US and the Third World: A Basis for Accommodation).

3.2 Intergovernmental Agreements: Methods for Industrial Co-operation on the Macro Level.

3.2.1

The Contribution of Intergovernmental Agreements to the Evolution of International Industrial Development Law.

Multilateral conventions are a major avenue for the revision of the present international legal environment for industrial co-operation, but this procedure is very cumbersome and time consuming. Consensus-making in multilateral conventions often results in generalities rather than concrete rules for action. The potential of bilateral inter-governmental agreements needs to be explored to promote industrial co-operation. It is in this light that the Joint Study mandate by GA Resolution 3362 (S-VII) relating to a study of a "general set of guidelines for bilateral industrial co-operation" has to be considered. The mandate assigns to UNIDO the study of how to elaborate methods which could guide and assist states, particularly developing countries, in negotiating intergovernmental agreements for industrial co-operation.

The general advantage of intergovernmental agreements between two or more states over multilateral conventions is that the reduced number of participants allows commitments to be more concrete and precise in terms of specific industrialization goals and strategies. The growth of industrial co-operation of intergovernmental agreements in number and in scope reflects the growing role of states (governments and governmental organizations) in the regulation of the world economic system. This seems to apply, albeit in a different scope and format to both West/South as to East/South relations. State participation takes the form of inter-state treaties and agreements of different character: international agreements between sepcialzed governmental organizations within their range of competence; state membership in the international economic organizations; the constitution of international legal relations between states and enterprises, which were formerly not subjects of international law; the establishment and activities of independent public - or publicly controlled - entities in international economic relations; and through state-issued promotion of and participation in operations by non-public entities and international organizations. 1/

1/ See for the growing role of state intervention in international economic relations Klein, E., in: Deutsche Landesberichte zum X. Internationalen Kongress für Rechtsvergleichung, Budapest, 1978, sections I/VI/VII; Seiffert, W./Zimmermann, B., ibidem.

Intergovernmental agreements may take highly varied forms, reflecting the differing degree of state intervention in concrete cases of co-operation at the project level. One can speak of a multi-level, pyramidal structure with highly abstract and general agreements at the top and concrete agreements setting out specific conditions for individual projects at the base. 1/

Agreements on the top level of intergovernmental relations frequently express general principles and intentions of co-operation. They are basically a declaration of the intention to provide a political environment which is favourable for co-operation and they will often form the umbrella for more specific agreements. 2/

On the basis of such general agreements on economic co-operation, agreements relating to co-operation in specific sectors or areas (e.g. development of natural resources, technical assistance) are concluded. They establish principles and methods of co-operation and an organizational structure (mixed commissions and sector-oriented working groups) to exercise - to differing degrees - some influence on the character and form of specific project negotiations.

Finally, intergovernmental agreements can be so specific as to be oriented at individual projects leading to the conclusions of intergovernmental project agreement. Here, either an institution is established to serve as a framework for one specific large-scale project or the contract for a specific project is directly incorporated into an intergovernmental agreement. The establishment of large industrial works where governmental participation is warrnated (e.g. Bokaro steel plant in India) or a combination of sale of high technology purchases with respective energy supply assurances (e.g. FRG/Brazilian nuclear power deal) are cases illustrating such close government-to-government co-operation.

The advantage of this approach to the creation of an international legal regime for industrial co-operation is that the rules can be bilaterally negotiated. They will be more concrete, the process of evolution less cumbersome and innovative solutions can be attempted. On the other hand, the bilateral negotiating process for intergovernmental agreements implies specific problems which have to be discussed in order to abide by the Joint Study mandate to seek "a set of guidelines for bilateral industrial co-operation". If two countries of roughly equal bargaining power and experience co-operate, there is little to be gained from any international involvement in their bargaining process. However, in the case of unequal bargaining

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1/ Seiffert, W., Intergovernmental agreements as a mechanism to promote Third World industrialization through economic co-operation, Hamburg, March 1979, report for the Joint Study;

2/ E.g. the agreement on economic co-operation between the FRG and the USSR in 1978.

power and of unequal or absent experience, intergovernmental agreements are likely to lead to an agreement which will reflect the lop-sided distribution of bargaining abilities. For example, on one side, we may find a relatively powerful IC wanting to protect its foreign investment and established interests but without any substantial interest or need in any more far-reaching involvement. Or the other hand, we may find a relatively weak developing country submitting to investment protection schemes in the not guaranteed expectation of attracting investment opportunities and a contribution to its industrialization objectives. It is in this situation that international activities as formulated by the Joint Study mandate can be useful. They should be directed at contributing to a higher quality and responsiveness of intergovernmental agreements relating to developing countries industrialization strategies, i.e.:

- intergovernmental agreements should not only reflect investment exporting countries defensive interests;
- but should contain some element of Third World collective action in order to reduce the impact of unequal bargaining power of the state partners (multilateral dimension);
- and should contain concrete commitments from each for the other side's respective interests in order to create a package expressing a mutually beneficial interdependence (quid-pro-quo approach) and thus go beyond declarations of good intentions.

It is with this background and these goals in mind that we will evaluate the present practice of intergovernmental agreements relating to industrial co-operation (section 2.2), develop proposals for expanding, modifying and revising present practices (2.3/2.4) and outline possible supportive activities by international organizations.

3.2.2

Intergovernmental Agreements for Industrial Co-operation: An Evaluation of Present Practice.

a) East/West Intergovernmental Co-operation Agreements.

Intergovernmental agreements on industrial co-operation have played a prominent role particularly in the context of East/West relations. The long-term agreements on economic, industrial, technical and scientific co-operation [1] are intended basically to create the preconditions for concrete co-operation.

1/ Cf. ECE Docs. TRADE/R.351 of 18 October 1977 and Add. 2 of November, 1977.

The actual supervision and implementation of an agreement are entrusted to a joint commission which serves as a forum for settling differences and for identifying and stimulating areas of potential practical co-operation. The follow-up activities are handled by sectoral or ad hoc working groups. The actual decision-making is left with enterprises, the major reason being that western governments consistently maintain to lack formal power to force their companies to any concrete obligations through this type of governmental co-operation. However, useful preparatory work for the decision-making is undertaken.

East/West co-operation agreements lift normal activities between western and eastern enterprises to the level of governmental concern. This is mainly a reflection of the organization of economic activities in centrally planned economies. Inter-governmental agreements of this sort are an attempt to stabilize the external influence on the domestic long-term economic planning; also, they are conscious attempts to obtain long-term assurances against disruptive and discriminative actions. They help to create direct relations between eastern and western enterprises, but utilize at the same time the hierarchical form desired by eastern countries. Critics of this form of intergovernmental interaction claim that the efficiency of the activities undertaken under the agreements is reduced as the meetings are said to be very time-consuming and not always adequately prepared and followed up. 1/ In evaluating the applicability of the East/West experience to developing countries, it cannot be proved that the quality or quantity of economic relations has improved notably because of these agreements. However, apart from the problem of efficiency, a certain stabilizing and stimulating effect for economic relations cannot be rejected. These forms and their limited effect on the actual decisions of western enterprises are a reflection of the institutional organization of eastern and western countries. For developing countries with a high degree of governmental control over the national economy, the form as advocated by eastern countries is probably suitable. It allows enterprise-to-enterprise co-operation to remain within the network of the national economic planning system. Also, developing countries could attempt to obtain through intergovernmental agreements at least the concessions obtained by socialist countries. However, it seems that intergovernmental agreements with western countries should be more specific, e.g. related to individual projects, and aim at a higher extent of government involvement than is the practice in East/West relations.

1/ Lotarski, S., Institutional Development and the Joint Commission in East/West Commercial Relations, A Compendium of Papers submitted to the Joint Economic Committee, US Congress, 25 August 1977, US. Government Printing Office, Washington, DC., Stock No. 052 - 070 - 04186 - 2, at p. 1039.

b) East/South Intergovernmental Co-operation Agreements.

Socialist countries use the instrument of intergovernmental agreements more extensively in their interaction with developing countries. In 1962, the CMEA countries had intergovernmental agreements on economic, scientific and technological co-operation with 34 developing countries; today they have such agreements with 78 developing countries. 1/ For developing countries, this system of intergovernmental agreements can take on added importance: it can help introduce some planning elements and more stability into the international interaction of their often vulnerable economies. Key co-operation projects are established between DCs' state sector and socialist states with long-term plans of each partner co-ordinated as far as possible. 2/

Intergovernmental agreements can be of a general nature or relate to individual large projects in specific industrial sectors. They are concluded on the state level, but also through administrative agreements on the ministerial level. The characteristic feature of such agreements is that the socialist countries assume direct obligations related to credits deliveries of equipment and performance of plants. The regulation of such projects is not subject to national regulation, but primarily to the terms of the international treaty in question. 3/

A very important issue concerning the effectiveness of intergovernmental agreements concerns the relation between the agreement and the contract on the enterprise/project level. In the East/South context, the content of project contracts is largely determined by the intergovernmental agreement. This agreement usually establishes the principles of price calculations; the delivery date stipulated in the contracts may not exceed the period of credit use as defined in the agreement. Contractual terms cement the terms of the agreement. The party's non-fulfilment of a civil law obligation in a contract usually means the non-fulfilment of the state's obligation under the international law through the transmission of the agreement. This feature reflects a characteristic difference between intergovernmental agreements employed in East/West and West/South interaction.

1/ Zevin, L., Economic Co-operation of Socialist and Developing Countries: New Trends, Moscow, 1976, p. 44; see also UNCTAD, Industrial Co-operation and Collaboration Arrangements in the Context of Industrial Restructuring, TD/185/Supp. 3 of May 1976; cf. also a paper by the CMEA Secretariat, Principles, Organizational Aspects and Some Results of Co-operation among CMEA Member Countries in the Field of Specialization and Partnership in the Industrial Production; Their Economic and Technical Co-operation with Developing Countries, Moscow, March 1979, prepared for the Joint Study;

2/ For East/South co-operation in planning cf. UNCTAD Doc. TD/243/Supp. 4 of May 1979;

3/ Boguslavski, M.M., Legal Questions of the USSR's Economic and Technical Assistance to the Countries of Asia, Africa and Latin-America, Sovietsky Yezhegodnik Mezhdunarodnogo Prava, Moscow, 1962, p. 118ff.

Of additional interest is that East/South intergovernmental co-operation agreements are used to set forth "general terms of technical assistance", i.e. rights and duties of parties in respect to various elements of technical assistance (payments, mutual settlement matters), contained in the agreement are applicable to individual contracts regardless of specific incorporation. This practice of negotiating between states uniform terms for applicability to or incorporation into specific project contracts is also a method employed in intra-CMEA economic relations. 1/ This method reduces the scope for negotiating variables and thus saves negotiation costs. It allows the co-operating states to find a balanced system of specific legal rules applicable to the respective industrial interaction and thus to reduce the vagaries and unbalances of individual bargaining situations.

The methods employed in East/South relations merit attention as they are steps towards a sufficiently concrete set of rules for international industrial co-operation, albeit on a bilateral basis. The areas covered could be widened to include rules applicable to financing, transportation, import and export transactions, turnkey plant contracts, dispute settlement and joint venture formation and operations.

c) West/South Intergovernmental Co-operation Agreements.

Intergovernmental agreements between market economies and developing countries relating to industrial investments primarily concern the protection of foreign investment. Such agreements have been concluded in large numbers particularly by the Federal Republic of Germany. 2/

Investment protection agreements have been entered into by developing countries primarily in the hope of attracting investment. However, the kind of investment expected has often not been forthcoming; also, there was no home state involvement in ensuring that the developmental performance of foreign investment corresponded to the potential. It is accordingly here that some measure of co-responsibility by the home state of the investor in contributing towards developmental performance of its investors seems warranted to parallel the co-responsibility the host state assumes through the commitments regarding investment security.

1/ E.G. General Conditions for the Delivery of Goods; General Conditions for Assembly and Rendering other Technical Services Connected with Deliveries of Machines and Equipment; General Conditions and Procedure for the Mutual Allocation of Maritime Tonnage and Foreign Trade Cargoes; General Conditions for the Constitution and Activities of International Economic Organizations; see for the full text of such General Conditions Butler, W., (ed.) A Source Book on Socialist International Organizations, 1978; and for an analysis with further references Seiffert, W., Die Rechtsentwicklung im RGW, Deutschland-archiv 12 (1979) 149ff;

2/ Cf. Langer, G., Rechtsschutz für Kapitalanlagen in Entwicklungsländern, 1973.

There have also been some inter-governmental agreements which provide a framework for industrial co-operation at the enterprise level, e.g. through facilitating the establishment of joint ventures. 1/ In some cases, market economies have entered into intergovernmental agreements directly concerning and regulating project contracts, particularly in cases where the developing country promised to provide a secure supply of vital natural resources. Such agreements have been concluded in the form of an exchange of commitments concerning supply of natural resources versus a transfer of related technology. 2/ Characteristic of such a form of unusually intensive government involvement of market economies may be the Brazilian/FRG agreement on co-operation in the field of nuclear energy of 1975. This agreement concerns urnaium exploration, uranium exploitation, uranium enrichment, delivery and installation of nuclear power plants and related matters. The operations are undertaken by private companies of the FRG and Brazilian state enterprises, partly in joint-venture forms. The basic terms of project co-operation are defined in "specific guidelines" which, on one hand, guide the specific enterprise contracts, and, on the other, are incorporated into the intergovernmental agreements through "instruments", i.e. joint declarations by the respective ministers. As a result of a complex contractual system, the FRG is able to sell nuclear power equipment and receives a secured supply of uranium, while Brazil obtains high-level nuclear technology. 3/

Finally, the sections on industrial co-operation in the EC/ACP-states Lomé convention of 1974 (Art. 26-39) and in the EC/Algerian co-operation agreement of 1976 (Art. 4-7) are of particular importance as, in the case of the Lomé convention, collective bargaining between groups of ICs and DCs has been the basis for the multilateral intergovernmental convention. 4/ The Lomé convention is concerned with infrastructure, development linked with industrialization; specific action regarding access to technology; industrial training schemes; schemes to help small and medium-sized firms and the establishment of a system for investment promotion

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1/ E.g. FRG/Brazilian agreement on co-operation in production and marketing of soya beans, Bundesgesetzblatt II, 1975, p. 367; see UNCTAD, Restructuring of World Industry, E/77.II.D.7 at p. 28;

2/ E.g. 1965 Algerian/French agreements concerning supply of petrolem in exchange for promotion of petrochemical industries in Algeria; e.g. the FRG/Venezuelan agreement on scientific and technical co-operation of 1978, where expectations concerning transfer of technology in petrolem development are combined with expectations concerning a secured supply with petroleum;

3/ Uranium apparently constitutes an area particularly suited for intergovernmental co-operation: an FRG/Indonesia agreement also provides for government-to-government co-operation, the actual performance delegated to a West German private enterprise; for the text of the KWU/NUCLEBRAS joint venture agreement which is covered by inter-governmental instruments, see Journal do Brasil, 26 August 1979, p. 30.

4/ For the text see UN GA Doc. A/AC.176/7 of 17 September 1975; for the EC/Algerian agreement EC Doc. CEE/DZ/F of 26 April 1976.

mainly through provisions of information and contacts (Art. 36). The EC/Algeria agreement emphasizes the processing of Algerian raw materials, mainly through provision of favourable financing (Art. 4 and 6).

The main difference between the East/South and the West/South approach is that - with the exception of projects of great relevance for ICs' supplies of natural resources - market economies have not been ready to assume direct obligations for the performance of project co-operation and have limited themselves mainly to providing of information and investment promotion in addition to favourable financing conditions. On the other hand, market economies governments are actively involved on behalf of their enterprises for investment protection, in the case of financing (export credit insurance) and through government agencies providing information, particularly information to facilitate company strategies. 1/ The problem is how to find methods and mechanisms which would allow market economy governments to accept the principle of co-responsibility to a greater extent than is generally done, while preserving the autonomy of enterprises characteristic of their economic system.

d) South/South Intergovernmental Co-operation Agreements.

Where industrial co-operation agreements serve as an instrument for planned regional industrialization, intergovernmental agreements are a prerequisite for effective industrial project co-operation. The various attempts in this field and the corresponding institutional arrangements may be broadly categorized as those employing complementary agreements, successive allocation systems, simultaneous allocation systems and sectoral programming. 2/ Co-operation at the project level, particularly between state enterprises, has often been promoted through the umbrella of an intergovernmental agreement. 3/ Here, the development of models of co-operation related to specific projects of bilateral or regional co-operation could be useful in providing negotiating countries with sufficient information concerning others' experiences and available instruments. To a considerable degree, one can here rely on studies and experiences resulting from Latin American co-operation and integration, 4/ and on some experiences related to regional co-operation and integration in the CMEA and the EEC.

1/ See UNIDO Doc. ICIS.68 of 28 April 1978, at p. 114ff;

2/ UNCTAD Doc. TD/185/Supp. 3 of May 1976 at p. 12ff;

3/ For a comprehensive collection of legal instruments relating to South/South co-operation see UNCTAD Docs. TD/B/609 of 7/1976/1977;

4/ Particularly those by the Instituto Para La Integracion de America Latina (INTAL), published partly in the Revista de la Integracion.

3.2.3

Improved Forms of Intergovernmental Agreements for International Industrial Co-operation.

The analysis indicates that considerable expansion and improvement of the present practice of intergovernmental co-operation agreements are possible. Such an improvement aims at emphasizing and expanding elements which have proved useful, but also at adding new elements. New mechanisms thus elaborated form part of the "toolkit" proposed by the Joint Study: They are instruments which should prove appropriate under various situations and for co-operation among the various economic systems; however, only few instruments would be suitable for every situation. The methods proposed attempt to give full credit to the principle of government co-responsibility and to the need for a greater stability of the legal environment. They also reflect the growing - albeit qualitatively different - role of states in international industrial co-operation.

a) Intergovernmental Framework Agreements for Industrial Co-operation.

Framework agreements concern the general structure of co-operation. They should have a positive effect on the undertaking and developmental performance of individual co-operation projects. For countries with a predominantly state-controlled economy, the development of joint planning methods for long-term programming of industrial co-operation through intergovernmental agreements seems warranted. 1/ Here, the issues are co-ordinating the two economies' industrial interaction on a long-term basis and effectively inserting individual projects into the co-operation programme. Intergovernmental agreements should provide procedures and joint institutions for co-operation programming, for project preparation and evaluation as well as for implementing projects and monitoring their performance. Extended studies on these issues, model agreements for co-operation programming and respective guidelines would have to be elaborated.

Even when a co-operating country is not a centrally planned economy, framework agreements nevertheless can provide considerable support for co-operation projects and their developmental perforamnce. On one hand, as in East/West relations, they can provide a favourable setting with some, even if limited, opportunity to identify areas of project co-operation and of establishing contacts for that purpose. Also, joint institutions can be set up for matching enterprises with projects in developing countries. It is here that the provisions of the Lomé Convention merit attention

1/ Cf. UNCTAD Doc. TD/243/Supp. 4 of May 1979.

and further development. Bilateral intergovernmental agreements could provide for jointly designed manuals of the conditions for co-operation in the respective countries. 1/

However, information alone does not seem to be sufficient to accommodate developing countries' interests in home country co-responsibility for the developmental performance of its enterprises. It is suggested that a joint process of selection of the co-operating enterprises might be a first step towards greater co-responsibility. Developing countries have little information about the ability of many IC enterprises; ICs, on the other hand, possess sophisticated systems of government contracting and procurement and have a considerable knowledge of performance capabilities. Information-sharing in this respect could greatly aid developing countries. It would also be consistent with the internal economic system of market economies. Other measures to increase home state co-responsibility in specific co-operation projects will be discussed below.

Of particular importance in framwork agreements seems to be the negotiation of uniform terms for the individual areas of industrial co-operation. The joint elaboration of uniform terms for individual areas of industrial co-operation through intergovernmental negotiations has proved a highly useful method in the East/South and the intra-CMEA relations. In intra-CMEA relations, uniform conditions for deliveries of goods (1968); for assembly and rendering other technical services connected with deliveries of machines and equipment (1973); for technical servicing of machines (1973); for mutual allocation of maritime tonnage for the constitution of international economic organizations; for individual contract types as licensing contracts; scientific co-operation contracts and for transportation contracts; for a joint system of dispute settlement and for inter-state planning co-ordination have been important steps to create a international body of industrial co-operation law. 2/ Under Art. 54 III, the EC has been very active in promoting the harmonization of rules, particularly in the areas of corporations law. The existence of mutually acceptable rules for industrial co-operation reduces the number of bargaining variables and hence bargaining costs; it provides for more certainty about the substantive content of the law applicable to industrial co-operation; it assists developing countries in generating specific legal rules appropriate for complex industrial co-operation for which no legal rules of adequate complexity generally are available. 3/

1/ Such manuals would enable co-operating enterprises to receive the necessary information for undertaking co-operative ventures from a mutually established source, e.g. the Hungarian/FRG joint Handbuch der Kooperation zwischen Unternehmen in der BRD und in der Volksrepublik Ungarn, Köln/Budapest, 1975;

2/ Seiffert, W., Deutschlandarchiv 12 (1979) 149;

3/ Strohbach, H., Report for the Joint Study, p. 19.

Finally, and perhaps this may be the most important contribution, the bilateral and multilateral creation of uniform terms for the respective areas of industrial co-operation would help establish a concrete and specific set of rules, another step in the evolution towards a universally acceptable International Industrial Development Law.

The negotiation of such sets of uniform terms between states would be made easier with appropriate international assistance. We can rely here on the successful example of the UN Economic Commission for Europe which has elaborated a large number of general terms through a joint East/West negotiation process. 1/ The successful work of the ECE could certainly be valuable, but uniform terms for North/South and South/South co-operation should take into account the specific problems of developing countries in industrial co-operation, particularly their greater vulnerability to non-performance and hence greater need for performance guarantees. 2/

Uniform terms could be drawn up on turnkey contracts, 3/ consultants contracts, employment of foreign experts, technical assistance, transportation, buy-back and compensation provisions, penalty and performance guarantee provisions, dispute settlement procedure and competent institutions, mutual recognition and enforcement of judgements and awards, the sale of machinery, repair and maintenance obligations. 4/ Also, uniform conditions for the constitution and the activities of corporations and of joint ventures could be elaborated.

The best method seems to be the elaboration of model contracts or clauses and of contract guidelines and manuals through specialized expert groups within the UN system. Care should here be taken that the specific problems of developing countries are considered and that such contract guidelines do not just rely on present practice, but attempt - continuously - to develop the quality of co-operation contracts. Governments negotiating bilaterally could incorporate such uniform terms and guidelines into their respective intergovernmental co-operation agreements. Here, they could be applied directly to project contracts or they could serve the parties negotiating for a project contract as a guideline or as terms which could be incorporated.

1/ E.g. Guide on Drawing up International Contracts on Industrial Co-operation, op.cit. at p. 27 for references to the various general conditions;

2/ Cf. Algeria's memorandum for the 1975 OPEC Conference, Annex XVI, op.cit.;

3/ See §§ 88-97 of the GDR's Code on International Economic Contracts;

4/ See for other areas where uniform terms could be of utility the discussion of intra-CMEA uniform terms supra.

c) Intergovernmental Project Agreements for Industrial Co-operation.

The other area where intergovernmental agreements could be improved is more related to co-operation projects on the enterprise level than to a general framework co-operation. It is often difficult to distinguish between the two types of agreements; however, a greater orientation to the problems of specific, particularly large-scale industrial projects, can be observed in many agreements, particularly those concluded by eastern states. 1/ Such agreements would concern an individual, large-scale project or a certain type of project already set forth in the agreement. The problem seems to be how to increase the scope of market economies governments' co-responsibility to a degree which is consistent with their economic system. To evaluate the possible scope for such increased home state co-responsibility, it is necessary to analyse two issues: (1) the market economies governments' potential to influence their enterprises and (2) the incentives and exchanges which could be offered by developing countries to motivate ICs to increase their co-responsibility in a substantial way.

(i) Market economies can - and this is reflected in their considerable involvement in projects vital for supply with energy and natural resources (supra) - mobilize and guide their enterprises action to a substantial extent. They can employ tax incentives, informal and formal co-ordination with and persuasion of the private sector, direct regulations prohibiting certain operations, provisions of preferential financing from government financial institutions, guarantees related to investment security (investment protection, investment insurance) and export credit insurance. In addition, the state enterprises of an operative, financing or supportive character can assume direct operative obligations or participate through loans or equity finance in co-operation projects. In the area of armaments exports of some ICs, governments co-operate closely with exporting industry and are ready to assume direct responsibilities for technical quality vis-à-vis the importing country. Also trade policies can have a direct impact on a co-operation project's economic viability. 2/

(ii) There seems also to be a potential for incentives to attract IC governments to assume a higher degree of co-responsibility. ICs, for instance, could be interested in DC assurances for stability of contractual and investment terms, in assurances concerning the supply with natural resources and energy, in preferential trading conditions with the respective developing country. 3/ ICs could exchange the assurance of access into IC markets for developing countries' manufactured products, preferential conditions in respect to financing and taxation, incentives for IC enterprises to transfer processing capacities to developing countries, adoption of appropriate adjustment assistance measures to encourage and facilitate the redeployment

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1/ But also the already discussed Brazilian/FRG nuclear energy co-operation project;

2/ See for an analysis of IC policy instruments UNIDO, Doc. ICIS.68 of 28 April 1978, at p. 112ff;

3/ E.g. preferential or at least non-discriminatory access to developing countries' markets for industrialized countries' products and investment.

of firms, IC incentives in favour of linkages of foreign investment in developing countries to the developing country economy. ICs could also assume some liabilities for the performance of their enterprises in developing countries.

The interests of both partners could be combined in package agreements expressing a quid-pro-quo exchange. In addition, a range of common interests could be taken up by intergovernmental agreements: a joint system of conflict resolution and joint measures to control abusive behaviour by TNCs (restrictive practices, transfer price abuses, discretionary shifting of work places). 1/

Intergovernmental agreements which relate to specific projects could contain provisions relating to:

- a partial assumption of the risk of non-performance of enterprises by their respective home countries, provided the projects in question have been jointly selected, a joint feasibility study has been undertaken and the project falls within the scope of the respective agreement; 2/
- provision for financing and market access conditions to enable the proper functioning of buy-back arrangements;
- host state guarantees relating to stability of the terms of industrial co-operation;
- host state guarantees relating to supply with energy and natural resources for the home state;
- intergovernmental co-operation to control enterprises.

The design of proper model agreements and negotiating manuals could assist developing countries to obtain some of these elements in their negotiations with ICs. It depends, ultimately, on the effort developing countries undertake themselves and their respective interests. A policy of co-ordinated action among developing countries and the exploitation of their potential for bargaining power - e.g. the control of natural resources and of export markets vital to ICs - might allow them to obtain some of the concessions mentioned. In particular, developing countries

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1/ It should be noted that in some ICs influential political groups support this type of action through intergovernmental agreements, see chapter 2.1.2/p. 21 of the "Orientierungsrahmen 1985" of the FRG's Social Democratic Party calling for intergovernmental control of the dominant influence of TNCs;

2/ It is interesting to note that the FRG's government, which is notably reluctant to accept an increased involvement in West German enterprise operations, has assumed de facto considerable liability in the case of its government-owned enterprise "DIAG". It has subsidized an otherwise bankrupt enterprise to allow it to meet its obligations in non-performance of produit-en-main contracts in Algeria. A joint, bilateral selection, feasibility analysis and negotiation process might have reduced the scope of this assumed liability to a considerable extent.

might collectively establish policies of preferential supply and trading conditions for such ICs which are more willing to accommodate developing countries' interests ("the like-minded-countries").

3.2.4

Organizational Structure of Intergovernmental Co-operation.

The organizational structure of improved intergovernmental industrial co-operation agreements can to some degree build on present practice. The system of mixed commissions, sectoral working groups and expert groups for the proposed elaboration of uniform terms of co-operation familiar from East/West co-operation would be an appropriate structure to organize the implementation of framework agreements. This applies also to the institutions set up by the Lomé agreement. 1/ However, care should be taken not to establish organizational structures where the effect produced does not correspond to the investment of qualified personnel work time which is particularly scarce in developing countries.

For specific intergovernmental project agreements, governments should strive to set up joint enterprises to identify feasible projects for industrial enterprise co-operation, to conduct jointly feasibility studies, to seek private and public sector financing and additional partnership and eventually implement co-operation projects. This avenue of establishing intergovernmental joint ventures with or without participation from the private sector promises to be most effective way to put the principle of co-responsibility into practice. It may produce a considerably greater cost efficiency than many lump-sum payments of development aid, as the know-how and the responsibility of the IC can contribute to greater effectiveness of finance used by joint enterprises. Mixed commissions and working groups would act as supervisory councils for the respective enterprises.

This idea is by no means revolutionary in West/South relations and certainly not in East/South and South/South relations. 2/ Market economies often have acted through state enterprises in developing countries adequately supported by the government. State- or para-state enterprises of major ICs have, for example, been very active in concluding joint venture agreements with the developing country's state sector in natural resources development. 3/ Other state enterprises or agencies

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1/ E.g. Committee on Industrial Co-operation, Art. 35; Centre for Industrial Development for Information-sharing; studies of the potential for industrial co-operation; for match-making functions, Art. 36;

2/ See UN, Petroleum Co-operation among Developing Countries, E.77.II.A.3.

3/ E.g. the French BRGM or French petroleum state enterprise; e.g. the Deminex of the FRG.

of industrialized countries have been active as partners or as financing agents for industrial projects in developing countries, at times favouring middle-sized industry partnerships and least developed countries. 1/ What is here proposed is an extension of such intergovernmental joint enterprise policies through co-operation on the macro-level through framework agreements and on the micro-level through project agreements and project joint ventures

3.2.5

International Action for Support to and Promotion of Improved Intergovernmental Co-operation Agreements.

To a certain extent, the proposals for improved methods of bilateral intergovernmental industrial co-operation are recommendations for states. For two reasons action on the international level, particularly by the appropriate international organizations, seems necessary to promote improved new forms and to prepare the groundwork for inter-state negotiations: 2/

(i) Action on the international level adds the necessary multilateral dimension to bilateral agreements. Bilateral agreements are often, through unequal bargaining power, tilted towards industrialized countries. Accordingly, there should be a compensatory multilateral dimension, where developing countries' collective approach would equalize bargaining power.

(ii) Many of the issues and proposals are too complex (e.g. the proposal to expand the practice of general and uniform terms for industrial co-operation) to be negotiated only on a bilateral basis. Here, either parties could not use the full resources necessary or the industrialized countries better equipped with information could force terms upon a developing country with an inferior information base. Accordingly, multilateral solutions - as model agreements, model terms, negotiating manuals, recommendations for multilateral framework conventions could serve as guidelines for negotiating governments and could - with or without revisions - be incorporated or referred to in bilateral agreements. Accordingly, it is proposed to set into motion a process of elaborating:

1/ E.g. the "Deutsche Entwicklungsgesellschaft, DEG" as a government partner for investment in developing countries or the Kreditanstalt für Wiederaufbau, KFW, as a financing partner in major foreign investment ventures of industrial enterprises of the Federal Republic of Germany.

2/ For the respective work by UNIDO and UNCTAD in the field of intergovernmental agreements see UNIDO Doc. ID/B/C.3/68 of 10 April 1978; UNCTAD Doc. TD/B/C.2 of 1 June 1977; cf. also ECE Doc. TRADE R.351 of October 1977.

- model agreements and negotiating guidelines and manuals for intergovernmental framework and project agreements;
- uniform terms for the respective areas of industrial co-operation, relying on work already done (by UNIDO; ECE; CMEA; EC; Rules of DC regional integration bodies, e.g. Andean Pact).

Such instruments should be elaborated by expert groups under the guidance of the proposed UN Commission for Industrial Development Law (UNCIDEL). They could be issued ultimately as a recommendation by the Commission and the authoritative bodies of the UN System and even, if deemed useful in light of the costs involved, be embodied in a multilateral convention. The result should be that, in line with the tool-kit approach, developing countries could rely on a set of appropriate model agreements, manuals and guidelines to facilitate their negotiation and to promote the evolution of new and more appropriate mechanisms. The proposed programme to expand bargaining assistance rendered by international organizations (infra) and the discussion of crucial issues of industrial co-operation (performance, marketing, control, stability, South/South co-operation) will add in substance to the potential of improved forms of intergovernmental agreements for industrial co-operation.

Ultimately, the major principles of international industrial co-operation and a continous machinery for implementation and revision could be set forth in a Code of Conduct on International Industrial Co-operation. Such a Code of Conduct would serve as the multilateral dimension of a legal system for intergovernmental co-operation on the framework and the project level.

3.3 Improvement of Third World Bargaining Abilities: Methods for Industrial Enterprise Co-operation.

Industrial co-operation and its effects on Third World industrialization are determined to a considerable degree in the process of bargaining which takes place between developing countries and their entities on one hand and foreign enterprises on the other. Progress in the achievement of industrialization goals depends accordingly on the ability of developing countries to expand and exploit their bargaining abilities, be it through internal action, through collective action or through internationally originated bargaining assistance. [1] The analysis and the elaboration of instruments for industrial enterprise co-operation has to be viewed within the context of implicit and explicit negotiations. Bargaining relates to the specific regime of individual co-operation projects (micro-level); it encompasses investment and foreign trade regulations which are de facto often a product of the bargaining

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1/ Cf. § 48 of the Lima Declaration;

process. [1] The bargaining power issue, however, is not only related for negotiations concerning the regime for specific projects; the international legal environment exercises a considerable impact on negotiations and renegotiations for specific projects. The objective of enhancing Third World bargaining power is inextricably tied to a revision of the international legal framework. The methods analysed and designed to promote the evolution of a New International Industrial Development Law are essential superstructural elements within a programme to improve Third World bargaining abilities. [2] Bargaining abilities are based on basically three factors:

(i) Ability to obtain appropriate information, to store, improve and use it effectively; [3]

(ii) the ability to apply an effective bargaining strategy through policy instruments available to developing countries;

(iii) the willingness to bargain seriously with foreign enterprises instead of being co-opted, associated or overwhelmed by them. [4]

TNCs have developed a wide range of co-operative arrangements - partly veiled by the rhetorics of free-market competition - which allows them to bargain jointly. [5] Particularly as risky Third World investment is concerned, TNCs increasingly join through investment consortia or through non-equity contractual arrangements, interlocking directorates and government-sponsored co-operative ventures. [6]

In addition, a large number of business- or government-sponsored industry associations or government information agencies for foreign economic relations [7] provide very effective fora for information-sharing, for informal discussions concerning

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1/ Cf. Wilde, in Kirchner et. al. Mining Ventures in Developing Countries, part I, 1979, p. 137 ff. and idem, Contribution to the Dijon Colloquium on a New International Information Order, May/June 1979;

2/ Cf. Meeting of the Eminent Persons to Discuss the Joint Study, June 1979;

3/ See O'Brien, C., The Political Economy of Information in a Changing International Economic Order, Dijon Colloquium, ct. May/June 1979;

4/ Cf. Vaitsos, Money as a Negotiable Input in International Business Activities, paper presented at the round table on negotiations with TNCs held at Yale University, 24-28 April 1978;

5/ E.g. the Uranium cartel is only one element in a series of joint action arrangements among TNCs, cf. Wood/Carrera, The International Uranium Cartel, Texas International Law Journal (1979) 59; Kronstein, The Law of International Cartels, 1973; UNCTAD, The International Market Power of TNCs, Doc. ST/MD/13 of 1978;

6/ E.g. see the working papers for the interregional project on TNCs in primary export commodities, elaborated by the Joint CTC/ESCAP Unit on TNCs, 1978; UNCTAD, Maritime Transportation of Iron Ore, E.74.II.D.4 at p. 34ff; a case investigated and decided by a US court - Kohn v. Amax, 322 Supp.1331 (E.D. Pa. 1971 - illustrates the degree of cohesion among TNCs' investing in DCs;

7/ E.g. the FRG's Federal Agency for Foreign Trade Information; or the highly effective "Association of German Machines Producers" (VDMA)

strategies in developing countries and for evaluation of developing countries. International banks provide also a supportive role for TNC strategy making. This informational network is complemented by a large number of private consultancy and information service agencies which cater to specific informational requirements of TNCs. 1/ Large TNCs themselves possess highly sophisticated systems for information collection, analysis and application through strategy design which may be superior even to governmental information agencies. This seems particularly to be the case of the large Japanese trading houses which have developed informational capacities of unequalled scope, efficiency and quality. Also, the diplomatic services of larger industrialized countries is geared to a high degree towards providing relevant information on strategic factors affecting DC/TNC bargaining to their enterprises. The major news agencies provide specific, business oriented information to their customers. In theory, developing countries could have access to some of these sources. However, their cost, practical problems of access and use of information theoretically available and the orientation of the northern international economic information network to the business community of industrialized countries 2/ make these sources of relatively little use for developing countries.

The high degree of cohesion, intensified through support of international financing institutions and the complex informational network linking governments, TNCs and financial institutions compares very favourably with the actual bargaining cohesion and informational co-operation of developing countries. It seems that the degree of effective informational co-operation among developing countries is insignificant. 3/ Mistrust and a host of practical obstacles 4/ seem to characterize Third World communication. 5/ This is also the case of the commodity producers associations which are operational on a level of information far below the level characteristic of the respective trade journals and professional information and consultancy services.

1/ E.g. Business International;

2/ Cf. contributions for the Dijon Colloquium on a New International Information Order, May/June 1979;

3/ Cf. to some degree, this may be because Third World politics on the scene of international conferences is undertaken by diplomats, while actual negotiating co-operation would have to come forth through the economics and industry ministries and the state enterprises;

4/ E.g. linguistic problems of communication, absence of established institutional settings for inter-country co-operation, instability of bureaucratic positions and of established long-term institutional and personal ties;

5/ E.g. OPEC; CIPEC; IBA;

Accordingly, what is necessary is a set of national and international institutions and strategies attempting to countervail - even if slowly - the formidable information network linking and supporting TNC bargaining. In that respect, much can be learned by looking closely at the mechanisms and institutions employed by TNCs and their home states to provide effective informational linkages. An international programme to assist Third World bargaining is well advised to examine closely how western and socialist states use the bargaining process to organize transfer, creation, linkages and mutual co-ordination. 1/ The negotiation strategies employed by TNCs have to be analyzed not only according to individual companies, but within the complex informational framework of TNCs, government and private consultancy informational linkages.

3.3.1

International Bargaining Assistance: An Evaluation.

A number of programmes of industrialized countries operate specifically to help developing countries inexperienced in international business negotiations. Such assistance can include feasibility studies; economic and technical consulting; economic, technical and legal advice for project negotiations and training for DC negotiators and administrators. The US is a major source of private and public programmes: US AID fulfils host country requests for legal, technical and economic experts; non-governmental organizations (such as the Harvard Institute of Development) and independent consultants, hired directly by developing countries or operating through foundation grants, also supply advice; (US law firms and consulting firms assume the greatest share of such advisory consulting). Negotiation strategy courses are offered by US universities (Georgetown; Berkely) and by institutions primarily in former colonial countries. 2/

Such programmes certainly effect a transfer of negotiating skill to developing countries. The problem, however, is that modes of business behaviour in host countries are influenced by cultural, political and economic biases of the industrialized countries supplying advice and training. That former colonial countries and the US offer such programmes may reflect an intent to remedy past colonialism imbalances and to regain good will; on the other hand, it is difficult to view such negotiating assistance as completely neutral. The policy of supplying negotiating advice may well fit into a pattern of integrating Third World elites into the prevailing cultural and business attitudes of major industrialized countries. 3/

1/ Cf. Ivanov, I.D., The State Monopoly of Foreign Trade in the USSR: The Experience and Conclusions of Interest for Developing Countries, Moscow, 1979, report prepared for the Joint Study;

2/ E.g. the French Ecole Nationale des Mines; The British Institute of Development Studies at Sussex University;

3/ Cf. the View Advocating the Integration of Developing Countries' Elites into the US System by Farer, Foreign Policy, 1976, p. 79ff.

On the international level, several international organizations offer advisory services for bargaining with foreign enterprises. The UN Centre on Transnational Corporations (CTC) offers advisory services and workshops for developing countries' negotiations specifically with TNCs. 1/ Also, the Commonwealth Secretariat organizes studies, consultancies and workshops dealing with natural resources negotiations. UNDP has also financed workshops on negotiations. UNIDO renders bargaining assistance through the preparation of negotiating guidelines and advisory services for individual countries. UNIDO's assistance for (pre-) feasibility studies can also be counted as pre-bargaining assistance. Finally, the elaboration of complex model contracts in the framework of the UNIDO consultations on fertilizer industries is primarily oriented towards assisting developing countries with negotiation models.

Another dimension of assistance is the establishment of data banks, providing developing countries with information relevant to negotiations. Among such data banks 2/ is the UNIDO project for exchange, storage and retrieval of information relevant for technology transactions 3/ and the CTC's establishment of an information system covering TNCs 4/ deserve special attention. Such systems could become useful for project design and the provision of background information but few serve the negotiation process directly. With the exception of the UNIDO Technology Information Exchanges System (TIES) they are involved only to a limited degree in building indigenous capacities and regional informational interaction. 5/ While certainly making a valuable contribution, such systems face several problems. Their cost effectiveness, i.e. their actual performance in meeting developing countries' needs in comparison with the investment made has not been examined. It is not apparent that such systems are sufficiently specific or up-to-date to serve the pressing negotiation needs; i.e. there seems to be a tendency for self-propelled growth of information systems and less a relationship between the system and its users. Such systems also lack the power and commitment of a coherent transnational professional group, as do specialized data banks. 6/ Finally, the information contained in such information systems seems often to rely less on co-operation with and among developing countries than on commercial information enterprises in ICs, whose information resources are tapped with UN funds.

1/ See Commission on TNCs, Fifth Session, Doc. E/C.10/49 of 27 March 1979;

2/ Cf. O'Brien, Cruise, Report for the Dijon Colloquium, May/June 1979, op.cit. at p. 7f;

3/ Industrial and Technological Information Bank, INTIB;

4/ Cf. report of the Fifth CTC session, supra;

5/ Cf. O'Brien, Cruise, op.cit. p.7;

6/ Cf. O'Brien, Cruise, op.cit. p.8 with specific references.

Finally, bargaining assistance is also rendered through the design of uniform terms in model agreements and information on pertinent national and international regulations provided by organizations like the ECE, UNIDO and CTC. An overall evaluation of the multifaceted aspects of negotiation assistance would have to concentrate on cost effectiveness and on the feed-back between actual use and services provided. It is probable that much useful assistance is effected through existing channels. However, one crucial objection has to be raised against the attitude underlying the bargaining assistance as presently rendered by most of the organizations concerned: At present, bargaining technology, i.e. experiences, recommendations, models, organizational instruments and legal concepts, are transferred from ICs to DCs. The transfer is predominantly effected by experts who are nationals of ICs or, as often the case, deeply influenced by the ICs bargaining attitudes and legal philosophy. 1/ This may even extend to apparently neutral technical criteria used which reflect the cultural and economic context in which they originate. 2/

Even international organizations may rely mainly on experts and bargaining behaviour models prevalent in the country in which they are based because such modes of behaviour are practical and comfortable. We can hence observe a pattern of a North/South transfer of "bargaining technology", perpetuating dependence on ICs patterns of organizing and negotiating industrial co-operation. Often, it is not "appropriate technology" which is transferred through the existing channels of negotiating assistance. This situation applies particularly to LDCs, which have not yet been able to develop an autonomous body of experience and are, therefore, most vulnerable to foreign expert advice.

3.3.2 Towards Appropriate Bargaining Technology by and for Developing Countries: International Organizations as Forum and Catalyst

There is a need to correct the present one-way North/South transfer of bargaining technology through the concept of national and collective self-reliance in bargaining. The basic attitudes underlying present North/South transfer programmes must be rethought and reformulated. An overall programme to support developing countries' bargaining would certainly familiarize developing countries with the existing level of bargaining techniques and instruments developed in industrialized countries; it should also encompass the rich experience of socialist states in negotiating with foreign enterprises. 3/ But the basic objective should be to provide an institutional setting for developing countries to develop through national and collective self-reliance authentic models

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1/ Cf. also Le Roy/Milingo/Traore/Wane, L'Endogeneité du Développement en Afrique Noire, Report for the Dijon Colloquium, May/June 1979; Lénoble/Ost, Le Droit Occidental Contemporain et ses Présupposés Epistemologiques, UNESCO, 1977 (Division for Development Studies);

2/ Cf. on the issue of cultural dependence Sauvant, Socio-Cultural Investment, Dijon Colloquium, May/June 1979; cf. also the report of the Director General of UNESCO to the 1976 General Conference of UNESCO, Doc. 19 C/87 of 30 September 1976;

3/ Cf. Ivanov, I.D., Report for the Joint Study, op.cit.

of planning, negotiating, organizing and implementing international industrial co-operation. The objective should hence be to replace dependence on IC-oriented systemic biases and assistance with self-reliant generation of negotiation instruments among developing countries. A process should be established to collect, disseminate and analyse information from developing countries. It would have to be designed to stimulate innovation, experimentation and evaluation of new mechanisms in order to allow each country to find policies for its optimally suitable specific situation. By setting into motion such a process, present contractual arrangements would be more rapidly transformed into contracts more responsive to Third World industrialization. A programme to support Third World bargaining should hence:

(i) stimulate and organize a system of bargaining co-operation among the more experienced developing countries on a basis of reciprocity;

(ii) provide for a transfer of bargaining experience from the more experienced developing countries to the least experienced developing countries. Co-operation should comprise information- and evaluation-sharing and finally, a gradual, practical evolution to appropriate forms of collective bargaining.

International organizations participating in such a process should re-think their basic attitudes and see themselves less as agents of a North/South transfer than as fora for discussion, as secretariats for publishing the results of common evaluation and as catalysts and organizational settings for experience-sharing among developing countries. It is not that such an attitude is completely innovative. Some developing countries have shared their considerable experience with other countries negotiating investment projects. Interviews conducted with state enterprise negotiators (in several Latin American countries and in Algeria) have indicated a strong interest in such an exchange and a readiness to participate. Some tentative steps have already been taken, particularly by the UNIDO technology exchange projects. 1/

Each organization of the UN system should orient its specific information and advisory capacities towards serving directly the bargaining needs of developing countries and towards communicative processes among developing countries to generate appropriate bargaining techniques and instruments. It is in the light of these considerations, that the subsequent sections will evaluate and elaborate specific mechanisms to act as vehicles for bargaining co-operation.

1/ See also the CTC workshop on negotiations in May 1978, UN Doc. E/C.10/50 of 23 March 1979.

3.4 A UN Programme to Support Developing Countries' Bargaining Abilities in Industrial Co-operation.

3.4.1

Model Contracts, Model Regulations, Negotiating Manuals and Guidelines.

Model contracts for the various types of industrial co-operation, [1] specified for individual sectors [2] could be of considerable use to DC-negotiators. They could first aim at transferring existing negotiating know-how to developing countries. This is the function of most model contracts and contracting guidelines elaborated at present. [3] Model contracts should cover the main areas of negotiation and provide information on the most recent and sophisticated contractual practices. They would have to be supplemented by negotiating manuals and guidelines.[4] These would provide up-to-date information on contractual practice, together with criteria allowing developing countries to evaluate alternative contractual approaches to a negotiating issue. Negotiating manuals might often be more flexible. By providing a checklist of issues and solutions and of evaluation criteria they assist an autonomous learning-by-doing process more. Accordingly, the model contract approach has to be linked to the more open-ended negotiating manual approach; both these methods finally have to be linked to an information-sharing system related to actual negotiating practice and contract administration among developing countries (infra).

The combination of model contract and negotiation manual has distinct advantages for developing countries: It allows the investment of considerable more time, talent and effort than is feasible for individual projects. Useful model contracts and manuals should go beyond a mere introduction of the main elements of a contract; [5] they should present issues of negotiation and possible solutions in considerably more detail. [6]

1/ E.g. turnkey projects, compensation and buy-back arrangements, co-production, joint ventures, investment contracts;

2/ E.g. fertilizer, petrochemical, mineral processing, light industry manufacturing etc.;

3/ E.g. the FIDIC model contracts; model contracts elaborated by national industry associations, e.g. the FRG's VDMA model contracts; the International Law Associations attempt to devise a model investment agreement; the various model contracts elaborated under the auspices of the ECE and the contracting guidelines elaborated by UNIDO;

4/ Cf. WIPO's Licensing Guide for Developing Countries, Doc. 620 of 1977 and UNIDO's draft, Guidelines for Evaluation of Transfer of Technology Agreements, 1979 (forthcoming);

5/ This has been the main emphasis of the earlier model contracts and respective guidelines drawn up by UNIDO until 1978;

6/ E.g. the draft model contract for the establishment of fertilizer plants in developing countries drawn up by UNIDO in 1978.

However, the approach of collecting and documenting current practice for easy use through a model contract plus a negotiating manual has some weaknesses. Present practice primarily represents the interests and mode of interaction of the Western business community. Educating developing countries in present practice reflects to a large extent an effort to integrate developing countries negotiators into this prevailing system. Model contracts appropriate to bargaining technology generated by and for developing countries, however, should not just transfer the state-of-the-art, but present a well-documented countervailing bargaining position for developing countries. 1/ They should assist developing countries through countervailing model contracts often elaborated under the auspices of national industry associations of foreign enterprises. Such model contracts and manuals should function as a catalyst for information-and experience-sharing among developing countries and as a vehicle to transfer thus generated methods and concepts among developing countries. A new, appropriate model contract or manual would still describe present practice, but it would moreover attempt to suggest innovative solutions to meet diverse situations, policies and industrial development. It would be particularly oriented to providing maximum bargaining positions for the specific requirements of developing countries and not just a possible meeting-ground for respective negotiations. In that function, innovative model contracts are not only providing bargaining assistance to developing countries' negotiators in adequately trained ICs techniques, but serve as a policy instrument to transform present contractual relationships into more development-oriented ones. Insofar, the model contract method is tied into the programme to promote the evolution of International Industrial Development Law. In this respect, it may be more flexible and effective and less costly than cumbersome multilateral conventions. Guidelines to be issued by such proposed organizations as the UN Commission for Industrial Development Law (UNCIDEL) could strengthen the weight of thus elaborated contractual forms and thereby reinforce developing countries' bargaining positions. Model contracts should be drawn up primarily in co-operation with developing countries state agencies and enterprises with adequate assistance form the UN system. The approaches could be global and comprehensive, but also regional and detailed. UNIDO could, for instance, design the umbrella for a model contract and manual while the Regional Economic Commissions could elaborate these instruments. It is not evident that global consultation of all parties concerned is always useful. This may introduce an element of conflict which should perhaps be better settled on the level of specific project negotiations. The model contract and negotiating manual strategy is viewed primarily as a countervailing strategy to create and share bargaining know-how vis-à-vis TNCs' institutional arrangements. The UN system is accordingly called to provide - compensating for existing unequalities - support services similar to those rendered by national and international industry

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1/ It is in that function that several developing countries, particularly state enterprises - have designed model contracts which serve less as a training instrument concerning present practice and more as a statement of the bargaining position and as a negotiating goal and evaluation criterium for its negotiators, see e.g. the model contracts prepared by PETROBRAS for oil service contracts or by Indonesia for natural resources investment.

associations to TNCs. Once basic bargaining equality has been reached, model contracts and negotiating manuals could enter a system of global or regional consultations. In that case, model contracts could evolve into universally accepted guidelines, for example issued by UNCIDEL, and finally into uniform terms of industrial co-operation. Bargaining assistance first would help to compensate existing unequalities and later lead to the evolution of a universally accepted international legal order for industrial co-operation. Such mechanisms gradually would approach the character of legal terms, parallel to their ability to represent a global consensus of equal partners.

3.4.2

An Integrated Industrial Investment and Project Service.

UNIDO has assisted developing countries in completing (pre-) feasibility studies through the preparation of pertinent manuals, training workshops and project advice. 1/ Important as these studies might have been for developing countries in evaluating and negotiating the social cost/benefits of proposed projects, it is felt that this area needs additional skills particularly at the branch level, e.g. for capital goods and mineral processing showing the benefits accruing to developing countries from local processing of minerals. Furthermore, manuals and guidelines need to be developed in the field of project implementation and investment. Services need to be rendered throughout the entire project cycle from project identification to investment follow-up.

3.4.3

Legal Consultancy for Project Negotiations.

Developing countries, particularly the least developed, often must choose between negotiating complex arrangements on their own without sufficient experience or relying on expensive western law firms and consultants, that may not always provide the most appropriate responses to specific DC problems. Through such organizations as the Commonwealth Secretariat or the United Nations Centre for Transnational Co-operation, free legal advisory services can be obtained. As there is no in-house capacity, it seems advisable to develop - through consultation and co-operation with the respective bodies of the UN system - some UN capacity of rendering legal advice. This is particularly relevant because the programme to promote an International Industrial Development Law and to elaborate model contracts and negotiating manuals requires the same

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1/ Manual for the Preparation of Industrial Feasibility Studies, New York, 1978, E.78.II.B.5;
cf. UN Guidelines for Project Evaluation, E.72.II.B.11; UN Guide to Practical Project Appraisal: Social Cost/Benefit Analysis in Developing Countries, E.78.II.B.3; cf. also the study prepared by the World Bank, Van der Tak/Squire, Economic Analysis of Projects, IBRD Staff WP No. 194, 1975, Ray/Van der Tak, A New Method of Project Evaluation, Finance and Development, March 1979.

type of legal qualification and capacity which is necessary for specific project advice. Instead of randomly contracting outside experts for individual advisory missions, a system should be established which links specific project advice, model contract design and assistance in establishing uniform terms of industrial co-operation in intergovernmental agreements. Such a system could provide co-ordination, information-sharing and feed-back on the micro- and macro-level of negotiations. It seems useful to establish within the UN system sufficient capacities for project-related legal advice. Such capacities should not be left in the general sphere of legal discussion, but tied as closely as possible to Third World industrialization programmes and objectives. The fragmentation of present efforts lacks co-ordination and a conscious effort to promote the evolution of a New International Legal Order for Industrial Co-operation.

3.4.4

Training in the Field of Project Preparation, Evaluation, Implementation and Project Negotiation.

Negotiation support requires not only documentative and informational assistance, but also measures to train developing countries' experts in relevant functions. Some training of this kind is offered through the CTC and UNIDO workshops on project negotiation and the preparation and evaluation of industrial feasibility studies. The large number of requests received for seminars an the field of project preparation and evaluation after the publication of the UNIDO Manual for the Preparation of Industrial Feasibility Studies suggests the current seminar activities should be restructured into an independent section concentrating on industrial project seminars covering project preparation and evaluation, implementation and contracting.

It would be particularly important to co-ordinate the rather disjointed practice of training workshops with the other activities relevant for supporting Third World negotiation abilities.

3.4.5

Developing Countries' Organization of the Industrial Co-operation Negotiation Processes: Assisting Developing Countries' National Self-Reliance.

A central weakness of developing countries in negotiations for industrial co-operation with powerful partners such as TNCs is often the absence of adequately organized and co-ordinated bodies for the collection and the utilization of relevant

information. 1/ At present, in many developing countries the dissemination, of information, experience and competence among a large number of government agencies allows for divisive strategies to be employed by TNCs. In addition, developing countries are hindered in drawing fully upon a pool of information and abilities when negotiating. It is not sufficient to establish information centres only on the international level such as the CTC. It is perhaps more important to develop developing countries' abilities to establish effective bodies for organizing industrial co-operation. 2/ It is hence suggested that studies be undertaken on the most effective organizations for the industrial co-operation negotiation process. In this context, the efforts of several developing countries (notably Mexico, Peru, India) to set up "Foreign Investment Centres" or specialzed agencies to administer the transfer of technology regulations merit considerable attention. Also, the system employed by the USSR in centralizing foreign trade bargaining may provide some concepts for developing countries. In the USSR, foreign trade is centralized in Foreign Trade Organizations (FTOs). FTOs also elaborate model contracts and hold informal meetings and consultations to improve their negotiating technique. Information is collected and analyzed in the Market Research Institute of the Ministry of Foreign Trade for use by the FTOs. Records are kept on the performance of contracted foreign enterprises and techniques developed for bargaining and the assessment of offers made by suppliers. 3/

From these considerations it appears that National Foreign Investment Centres, acting as focal points for the collection and evaluation of information on negotiation to be used by government agencies and state enterprises empowered to deal with TNCs, might be a suitable institutional arrangement to promote developing countries' bargaining abilities. Such centres could be organized as bargaining information centres to render advisory services for other developing countries' agencies and enterprises or

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1/ The necessity to strenghten the developing country's national machinery for negotiations with TNCs has also been emphasized by the UN Group of Eminent Persons, cf. UN, The Impact of Multinational Corporations on Development and International Relations, E.74.II.A.5 at p. 10;

2/ At the meeting of Eminent Persons to Discuss the Joint Study it has been expressed that the efficiency offered by developing countries through effective organization was an important bargaining asset and that own, self-reliant efforts by developing countries to develop their bargaining abilities may be more effective than international assistance related to specific projects. The same view has been expressed through interviews with developing countries' negotiators in government agencies and state enterprises;

3/ For an extensive discussion of USSR institutional arrangements to improve USSR bargaining abilities in dealing with TNCs see Ivanov, I.D., The State Monopoly of Foreign Trade in the USSR, Moscow, 1979, report prepared for the Joint Study.

they could have some authority over the foreign industrial co-operation process. They could serve to elaborate model agreements among state enterprises and to evaluate experiences collected by the various enterprises. 1/ Also, such centres would be appropriate focal points for inter-country co-ordination and for communication with international organizations.

Obviously, it must be left to each country to decide what institutional arrangements would best suit its particular requirements. However, help in evaluating the present organization 2/ and elaborating improvements might be of great use. In that context, emphasis should be laid on transferring successful experiences from one country to countries which have not yet been able to collect and evaluate such experiences.

3.4.6

Increased National Economic Integration through Industrial Co-operation Projects.

Foreign investment in developing countries traditionally has been characterized by its enclave structure, i.e. by its insulation from economic, social and legal environment of the host country. 3/ This has placed developing countries at a considerable disadvantage, as they have to forego the advantages offered by industrialization according to the availability of national natural resources. 4/ National economic integration is hence an important bargaining issue, particularly in the case of commodities, but also of packaged purchases of industrial installations. 5/ New methods to promote Third World industrialization accordingly must place some emphasis on policies to increase the national economic integration of industrial co-operation projects. 6/ Such strategies can be pursued through intergovernmental agreements (supra) or through better co-operation of producers of commodities. 7/ Respective strategies can also be pursued through negotiating for specific projects, particularly if the access to a strategic commodity or to markets for industrial plants require commitments to economic integration.

1/ In interviews with developing countries, the need for such external co-ordination and experience-sharing has been repeatedly emphasized;

2/ As already rendered by the UNIDO technology assistance operations;

3/ Cf. Girvan, Corporate Imperialism, 1976;

4/ See chapter on processing on minerals of the Joint Study;

5/ Judet, A Propos du Contrat Clé en Main, Le Problème de la Maitrise de la Technologie, IREP/Grenoble, May 1977;

6/ Cf. § 53 of the Lima Declaration.

7/ See chapter on mineral processing.

Within a UN programme to support Third World bargaining abilities, the possible impact of policy instruments should be studied in the following areas: 1/

- processing and fabrication of nationally or regionally available natural resources;
- increasing the local supply and subcontracting linkages (local content);
- national participation in transporting and shipping of commodities;
- localization and qualification of the national labour force through industrial co-operation; 2/
- national participation in the international marketing of produced commodities.

The UN, particularly UNIDO in conjunction with UN bodies concerned with natural resources (UNCTAD; UN Centre on Natural Resources; CTC) could undertake in-depth studies on the industrialising potential of commodities and of available negotiating methods on project and intergovernmental levels to exploit such a potential. It could also assume a corresponding task in the area of delivery of industrial complexes.

3.5 Collective Self-reliance in Bargaining: Towards Collective Developing Countries' Bargaining.

Collective action has been emphasized as an important method for generating countervailing DC bargaining abilities. 3/

The methods and mechanisms already discussed are oriented greatly towards providing a catalyst and an institutional vehicle for informational exchanges among developing countries. Through gradual and informal steps, they approach some measure of co-ordination in bargaining. However, the intensity of co-operation among ICs and TNCs and the relative weakness of Third World bargaining power require a greater effort to achieve collective Third World action. Some specific methods will be explained below. They are closely related to the methods proposed to promote South/South industrial co-operation.

1/ For an in-depth analysis of host state instruments to promote economic integration and industrialization in natural resources through foreign investment cf. Wälde, Transnational Investment in the Natural Resources Industries, Law & Policy in International Business, 1979, p. 691-774;

2/ Cf. report by M.M. Boguslavski for the Joint Study;

3/ See the Lima Plan of Action, § 60 (k), § 34 and 38 of the Declaration of the Arusha Conference, and the Manila Conference; cf. UNCTAD, Economic Co-operation among Developing Countries, TD/244, May 1979, §§ 36ff.

3.5.1

UN Facilities to Promote Bargaining Co-operation Among Developing Countries.

The UN system could provide an institutional setting for developing countries' sharing of information, experiences and evaluation in industrial co-operation. Such a system would help reduce the possibility for TNC-desisive strategies. Interest for such a scheme, if informally organized, has been expressed often by negotiators in developing countries' ministries and state enterprises. 1/ Informally, some co-operation of this kind already has been undertaken but spontaneously and without adequate international institutional support. Some elements of such a scheme are being implemented through the UNIDO Technology Information Exchange Scheme. In principle, the competent UN agencies would establish an institutional setting to group-for the specific sectors - interested developing countries (particularly negotiators from ministries, foreign investment boards, state enterprises) and to organize discussion- and information-sharing on the basis of reciprocity and confidentiality. Much could be learned from how TNCs are co-ordinated and from traditional TNC-cartel organizations. In the beginning, the relatively few countries with rather extensive bargaining experience would participate. The information-sharing among state enterprises could begin with the exchange of information on contractual practices and model contracts in use. Gradually, informal discussions could be directed at elaborating and sharing a model contract or certain contractual guidelines. The UN body would service such groupings and provide appropriate expertise. The approach could be linked to the proposed process for designing model contracts.

At present, political frictions and sensitivities create considerable obstacles even for informal co-ordination attempts. To overcome them, the UN could provide a meeting ground sufficiently neutral to allow informal co-operation. Furthermore, the UN could attempt to collect information and evaluations and disseminate them to developing countries with less experience, i.e. countries which could not hope to receive information on the basis of equality and reciprocity.

Of particular value would be a project and enterprise performance referral service (PEPERS). 2/ Developing countries' negotiators have often said that access to information about specific projects, techniques and enterprises' performance in other

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1/ This policy was also recommended by a Round Table on Negotiations with TNCs to strengthen the negotiating capacity of developing countries, convened by the UNCTC, cf. UN Doc. E/C.10/50 of 23 March 1979 and the respective background papers to be published;

2/ The 1972 Georgetown Conference of Foreign Ministers of Non-Aligned Countries proposed to set up a Committee of Experts on Foreign Investment to organize the exchange of information on the operations of TNCs; this proposal was also raised at the 1973 Algiers Summit Conference of the Non-Aligned Countries, cf. Jankowitsch/Sauvant, The Origins of the NIEO: The Role of Non-Aligned Countries, in Sauvant (Ed) The NIEO: Changing Priorities on the International Agenda, 1979/1980. However, apparently little has been done by the non-aligned countries to implement these proposals.

countries would be helpful in evaluating similar projects. TNCs, for example, have at their disposal - often through financing institutions - highly sophisticated instruments to collect, evaluate and disseminate strategic information about their respective developing countries' negotiating partners. A similar support system would be useful to developing countries as well. Through such a referral service interested developing countries could share experiences concerning specific projects and enterprises with other developing countries. Appropriate UN agencies would act as match-makers and go-between, principally operating a register of contracts, projects, techniques and enterprises active in developing countries and would co-operate with the agencies or government experts. The establishment of national foreign investment centres as proposed (supra) would certainly facilitate such an exchange. Tax and police co-operation among several developed countries has demonstrated the potential of both informal and formal arrangements for mutual aid and assistance.

Finally, the organization of regional and international training programmes for developing countries' negotiators would also be an instrument for fostering negotiation co-operation among developing countries in an informal and perhaps more effective way.

3.5.2

Regional and Sectoral Joint Developing Countries' Enterprises for Collective Bargaining.

The objective of collective bargaining by developing countries needs instruments which are flexible enough to accommodate the often highly diversified interests of participating partners. Industrial joint ventures, particularly but not exclusively among state enterprises, appear to be a promising instrument to increase developing countries' bargaining power. 1/ Accordingly, the UN should attempt to promote industrial joint venture formation among developing countries on a regional or sectoral level. The experience of socialist states has shown that such aggregated power effected through centralized bargaining for technology, equipment, financing and investment can considerably increase the benefits. 2/

The formation of buying and investing cartels and consortia in western ICs reflects the same experience. Inter-DC industrial joint enterprises could fulfil the functions of:

- collective bargaining for the purchase of technology;
- collective marketing;
- collective bargaining for location of foreign investment, linked to regional programme industrialization.

1/ Cf. § 60 (m) of the Lima Declaration; UNCTAD Doc. TD/244, May 1979 at §§ 45ff; 73ff;

2/ Cf. Ivanov, I.D., The State Monopoly of Foreign Trade in the USSR, op.cit.

3.5.3

Harmonization of the Legal Regime Applicable to Industrial Co-operation.

A constant weakness of developing countries' negotiations is the potential for divisive strategies exploited by TNCs. Together with institutional settings for information-sharing (supra), the harmonization of the legal regime applicable to TNC-negotiations is a mechanism to narrow the scope for divisive strategies. 1/ The UN should stimulate and support developments towards harmonization of investment policies. It is evident that the goal of uniformity in such important areas is not achievable within the next decades. 2/ However, one can envisage the elaboration of a global conceptual framework for harmonization, which can be worked out on a regional level. In this context, the successful experiences of major industrial countries and regions in harmonizing their respective legal framework reflect the crucial role of legal harmonization in industrial co-operation and integration of economic regions. 3/ It is not that these experiences can be completely transferred to developing regions, but they at least demonstrate the utility of legal harmonization in regional integration. 4/

The most realistic way appears to be the elaboration of general, global recommendations. Only gradually, this phase would be followed by the conclusion of multilateral treaties. At first these would only give broad guidelines for harmonized treatment of foreign investment and international industrial co-operation. A comprehensive, uniform legal regime would be envisaged as a long-term goal. Instruments aiming at a gradual, regional and differentiated harmonization of foreign investment and international industrial co-operation should be negotiated only by the respective groupings of developing countries. Insofar, they would differ from the negotiations for present Codes of Conducts. Individual issues of legal harmonization in the South/South context will be considered in the following sections (incentives, taxation, control, promotion of South/South industrial co-operation).

1/ Harmonization policies, however, have to be linked to policies of programmed industrialization to be fully effective, cf. Vaitsos, La Función de las Empresas Transnacionales en los Esfuerzos de Integración Economica en America Latina, UNCTAD Seminar on TNCs in the Latin American Integration Process, Lima, 12 June 1978;

2/ UNCITRAL has been making a very slow progress in the uniformization of the relatively uncontroversial issues of international commercial law and has up to now not found the will to enter more controversial fields, cf. Doc. A/CN.9/171 of 2 May 1979;

3/ Cf. Seiffert, et. al., Sozialistische Ökonomische Integration, 1976; Mestmäcker, Europäisches Wettbewerbsrecht, 1974;

4/ Cf. BID/INTAL, La Dimension Juridica de la Integración, Europa/Africa, 1974; America Latina, 1974; UNCTAD, Economic Co-operation and Integration among Developing Countries, Compilation of the Principal Legal Instruments, TD/B/609, Add. I, vol. I-V, 1976.

3.6 Organizational Issues of a Comprehensive UN Programme to Support Third World Bargaining.

Certainly a range of options to organize the structure of the proposed comprehensive UN programme to support Third World bargaining exists. Some objectives need particular attention: the organizational structure of such a programme should not be disjointed and should allow for sufficient co-ordination and linkages. The present practice seems to be highly fragmented and in need of a coherent organization and conceptual basis.

Economic, technical and legal bargaining assistance should be closely connected. Activities related to the macro-level (e.g. intergovernmental agreements) and those related to the micro-level should also be connected. The whole bargaining programme should be very closely linked to the proposed methods to promote the evolution of an International Industrial Development Law and competent UN bodies (UNCITRAL). Also, care should be taken to orient the programme closely to the needs of those it serves and to avoid the risk of a self-propelled bureaucratic growth visible in current practice. Finally, a strong orientation towards project and overall goals - such as promoting a high-quality Third World industrialization - is necessary. A programme should rely on developing expertise in constant co-operation with developing countries; such expertise should serve principally as a focal point, a catalyst and an information receptacle for developing countries.

UNIDO, in light of its experiences in project oriented advisory services and its projects related at technology co-operation among developing countries, should be closely involved in such a system. The UN CTC's advisory activities would have to be co-ordinated with respective UNIDO programmes. New programmes should be located in the context of such a co-operation. Finally, a re-orientation of UNCITRAL and a respective close co-ordination with UNIDO seem warranted, along with the establishment of a body oriented exclusively at promoting a new International Industrial Development Law.

To group the proposed project bargaining assistance activities under an organizational umbrella, the establishment of an agency concentrating on international bargaining assistance should be considered. At present, several UN-subsystems (UNIDO, CTC, UNDP) are dealing with negotiating assistance. All suffer from the bureaucratic constraints: there is no evaluation of success; the establishment of in-house know-how is relatively insignificant; outside consultants, mostly from the country where the organization is based, perform a North/South transfer. The feed-back between the needs of actual and potential users and an often expanding bureaucracy is limited. Accordingly, the proposed Consultancy Agency should be modelled after the organizational rules proposed for the Deep Sea Enterprise. It should be financed, on a gradually downward sliding scale, by the UN, but increasingly through voluntary contributions. It should not render services free of charge, but charge fees. Only such a

system would provide a valid indicator of its performance. The task of the Consultancy Agency should be to lessen developing countries' dependence on ICs' private law firms and on the consultancy services offered by private companies and sponsored by IC governments. It would provide legal, technical and economic advice.

CHAPTER 4: DIVERSIFYING THE AGENTS OF INDUSTRIAL CO-OPERATION: MOBILISING THE POTENTIAL OF MIDDLE-SIZED ENTERPRISES AND OTHER NON-TNC ACTORS

The present structure of international industrial co-operation favours TNCs to the detriment of enterprises of small and medium scale, particularly those from DCs. It is mostly in the role of accessory and dependent suppliers to TNCs that these enterprises become involved in North/South or South/South industrial co-operation. Non-TNC actors seem to possess a considerable potential for contribution to Third World industrialisation: smaller companies are used to produce effeciently at competitive costs for relatively small markets, as it can be found in low income countries. Their technologies are less capital intensive and, therefore, employ more labour. 1/ Their production and marketing process is organisationally less sophisticated and, therefore, requires lower managerial skills. Medium-sized enterprises seem to be more adaptable to the social and cultural environment of host states and offer greater scope for local innovation. Also, medium and small-sized enterprises tend less to create cleavages between highly developed centres and an underdeveloped periphery in DCs. Finally, medium-sized enterprises do not create the problem of great economic and political power steered through a removed, non-national global decision process which is characteristic of TNCs. 2/

These characteristics of industrial co-operation with medium-sized enterprises give them an advantage over TNCs in the DC view. However, there are substantial obstacles against involvement of non-TNC actors in industrial co-operation. Large TNCs enjoy considerable advantages over medium-sized enterprises, particularly in respect to their greater experience and managerial capacities. Middle-sized enterprises are exposed much more to the political and economic risks of industrial co-operation in DCs. They lack the "safety net" of TNCs and can not spread failure risks among a sufficiently large number of projects. International and public infrastructural services are not geared to middle-sized enterprises, making financing more difficult. Also, the network of investment and trade regulations in DCs is often geared to control TNCs and is, accordingly, unmanageable for non-TNC actors

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1/ Gordon, The Bank and the Development of Small Enterprises, Finance and Development, 1979, March issue;

2/ Cf. Neck (ed.) Small Enterprise Development: Policies and Programmes, ILO publication 1977; IBRD sector policy paper, Employment and the Development of Small Enterprises, February 1978; de Vries, Industrialisation and Employment: The Role of Small and Medium-sized Manufacturing Firms, in International Economic Development and Resource Transfer, 1979 (forthcoming)

possessing considerably fewer capacities to handle regulatory obstacles. This situation impedes beneficial industrial co-operation and presents a problem whose solution would seem to be in the interest of both DCs and ICs. DCs, as home states of non-TNC enterprises, are hindered in exploiting their potential to participate in a new international division of labour and increasing their export potential and foreign exchange earnings. DCs, as host states, could expect from a diversification of the agents of industrial co-operation a considerable contribution to their developmental objectives [1/] and an increase of their bargaining power as they reduce dependence on a few powerful TNCs. Promoting industrial co-operation with non-TNC actors is also an instrument of collective self-reliance in the South/South context. Mechanisms to enhance the potential for non-TNC industrial co-operation appear also to be in the interest of ICs. They provide a means for enterprises of small and medium scale to participate in industrial co-operation and hence fit into the middle and small industry programmes of several ICs. A programme to promote the role of non-TNC actors should represent a package of mutual interest of home and host states, DCs and ICs. It would be oriented to providing preferential conditions for non-TNC actors to compensate for existing competitive disadvantages.

4.1 Promotional Efforts in Favour of Non-TNC Actors: Present Programmes

Today some ICs operate programmes specifically to promote middle-sized enterprises' foreign investment in DCs. For example, the "German Development Corporation" (DEG) promotes partnership investment by West German enterprises, particularly of medium scale, in DCs by making equity investment or quasi-equity loans, by providing advisory services for project planning and execution, by matching German and DC partners and by providing systematically investment data on selected DCs. [2/]

The industrial co-operation programme of the Lomé Convention (Art. 26 ff) aims specifically at involvement of small and medium-sized firms, with primary importance given to such firms in the participating DCs (Art. 26 (f)). However, the Lomé programme is limited in the provision of information, financing and promotional activities and does not provide for an equity or quasi-equity participation as assumed by the DEG.

1/ e.g. transfer and generation of appropriate technology, employment creation, reduction of internal center-periphery tensions.

2/ DEG's investment in a project is not permanent, but limited in time. DEG's present capital is DM 1 billion; its only shareholder is the FRG; joint ventures are promoted as the best form of industrial co-operation; DEG works on the principle of private enterprise and profitability is expected from supported projects. Adequate investment protection is a prerequisite for support. A third of investment is located in LDCs. Only DM 11 million have been reported as overall losses up to now, because of careful project evaluation, see Annual Report for 1978.

The World Bank supports the activities of small and medium-sized enterprises in DCs primarily through loans and guarantees, through an expanded programme for equity participation for shorter periods of time, leasing of installation and equipment and formation of a corps of industry advisers to render consulting services specifically for middle-and small-scale industry. 1/ However, the orientation is developing of small-and medium-scale industry in developing countries, not at the participation of such firms in international industrial co-operation.

UNIDO has collected experiences in promotion of industrial co-operation of small and medium enterprises in the context of its Investment Co-operative Programme (ICPO), its Industrial Development Fund 2/ and its liaison offices in several ICs. The result of its experiences have been proposals to expand promotional services, particularly through co-operation with non-governmental industry organisations and through programmes to improve the contacts among small-scale industrialists and governments and financing organisations. However, also these proposals are more oriented at fostering small-and medium-scale industrialisation in DCs and less at fostering industrial co-operation over national frontiers, particularly in the South/South context.

The evaluation of existing practices to promote small- and medium-scale industrial co-operation indicates that enterprises of that scale, particularly from DCs, still need considerable efforts to reduce the obstacles faced by non-TNC actors. On one side, the dimension of promotion and matchmaking has to be further developed, perhaps on the lines of the Lomé Convention. In addition, advisory services and strategic information for middle-sized industry co-operation are necessary to provide knowledge and experience similar to what is available in the information systems of TNCs. Thirdly, a safety net for non-TNCs is necessary which takes into account the specific and substantial vulnerability of non-TNCs to the political and economic risks of North/South and South/South industrial co-operation. Insofar as ICs already provide effective services to their own enterprises - an example being the DEG of the FRG - no additional programme except co-ordination and information-sharing seems necessary. However, for enterprises particularly in DCs where such a programme does not exist, many additional efforts are warranted. Here, proposals could rely to some extent on the effective support given to middle-sized enterprises by such government-sponsored agencies as the DEG. All these methods and mechanisms have to recognize that non-TNC actors require considerably more safety, advice and experienced participation than the large TNC which can be operated on its own.

1/ Gordon, D., Finance and Development, 1979, March issue.

2/ Cf. Doc. ID/B/C.3/60 of 14 October 1977.

It is hence a model of tripartite co-operation, home and host states and international body which serves as the guiding concept for the policy package elaborated below. In such a tripartite model of co-operation, the emphasis should be in addition to informational and promotional activities of an already familiar character - on reduction of risks. For the host state, this implies that some form of reduction of the risks associated with small - and medium-sized enterprises (non-perfomance, unreliability, absence of established reputation) has to be found. For the home state and its enterprises, a policy package must provide a reduction of the political and economic risks associated with DC co-operation. On one hand such risk reduction strategies consist of screening processes and careful evaluation of co-operation projects and, on the other, a direct assumption of the risks involved by governments and international organisations which are more capable to assume such risks than the small- and medium-scale enterprises participating in industrial co-operation.

4.2 A Tripartite Model of Industrial Co-operation with Non-TNCs

A programme to facilitate and promote co-operation with non-TNCs would at first have a match-making function, i.e. to identify and bring together feasible projects and partners. It would have to provide information and advisory services for partiners in home and host countries. Advisory services would relate to co-operation projects; to financing alternatives; to legal, technical and economic elements of co-operation projects. Advisory services would also cover (pre-) feasibility and project implementation analysis. Most of the elements of such a programme can already be found in operations undertaken by UNIDO and as established in the Lomé Convention. However, these activities would have to be directed specifically at South/South co-operation, as here obstacles are the greatest and assistance seems to be able to have a great mobilizing and supportive effect.

Of considerable importance would be strategies and methods directed at risk reduction. Risk reduction would at first be sought through the advisory services. In addition, a tripartite model of industrial co-operation should be established to make the following contributions:

(i) Host Country

The host country would have to specify what development priorities are a precondition for the identification of suitable projects. Secondly, it has to establish a project pipeline, eventually assisted by international organizations. Thirdly, it should establish monitor contacts and co-operation with the co-operating enterprises. Fourth, it should specify in detail the conditions for capital transfer and repatriation, import of raw materials and capital goods, exports of products, utilization of domestic capital and natural resources. Finally, it should provide guarantees for the stability of the contractual conditions.

(ii)

Success depends essentially on a strong support from an international agency. Such an agency should, in addition to supportive operations discuss, provide loans to co-operative projects which have been approved by the agency and the home and host contries. But the crucial elements of the policy package proposed would be performance guarantees granted by the home country and channelled through the international agency for those projects which have been mutually approved. The guarantee would assure the host country that the co-operation project would perform as envisaged. It would thus reduce the obstacles against non-TNC co-operation created by the risk perception of the host state. It would be laid down in a respective guarantee contract.

(iii) Home Country

The home country should establish a national industrial co-operation agency which is responsible for the execution of the policy package proposed and assumes the necessary informational and promotional responsibilities. It would participate in joint evaluation of projects with the international agency and host states. Primarily, it would give a performance guarantee to the international agency for its enterprises' approved co-operation projects. Finally, it would provide a comprehensive investment guarantee to its enterprises for a specified minimum rate of return. This guarantee should be tied to commitments by the enterprise and stipulated accounting procedures to make sure that sufficient performance incentives exist in spite of a guaranteed minimum rate of return. This guarantee system would reduce the risks faced by the non-TNC enterprise in industrial co-operation. It would involve the home state in the industrial co-operation process (co-responsibility), but still leave the operational autonomy to private enterprises. Guarantees to the enterprise could be replaced by equity investment - as in the DEG case.

The international agency should assume the role proposed for home states where enterprises from DCs which are not able to shoulder the risks and administer effectively the process of project selection and execution in industrial co-operation. Basically, the proposed policy package seeks to involve home states, host states and the operating enterprises in a co-operation project with an international agency acting as a mediator and as a supporting agent for DC home states. The international agency should have access to a speical fund to back up guarantee for co-operation undertaken by non-TNCs from DCs. A cost calculation of such a programme [1/] indicates that the costs would be manageable.

1/ Hoffmann, L /Sanders, H., Industrial Cooperation in the Field of Small- and Medium-Scale Private Foreign Direct Investment in Low Income Developing Countries, for the Joint Study, Vienna, 1979.

4.3 Institutional Setting

It seems useful to concentrate the various strategies discussed in one agency of a semi-autonomous character ("UN Industrial Development Corporation"). Such an agency could be attached to - or developed out of - presently undertaken activities such as an expanded UNIDO Industrial Development Fund and Investment Co-operative Programme Office. The agency would expand present investment and industrial co-operation activities and be oriented strongly towards industrial co-operation among DCs. As to specific projects, the agency would be involved in seeking out screening and evaluating co-operation projects. The agency would then participate in the economic and political risks of the project, either directly through equity participation and guarantees on behalf of enterprises from DCs or through mediated equity participation and respective guarantees on behalf of IC home states.

CHAPTER 5: DYNAMIC STABILITY FOR INDUSTRIAL CO-OPERATION: TOWARDS A SYNTHESIS OF STABILITY AND DEVELOPMENTAL RESPONSIVENESS

5.1 Stability as a Prerequisite for Mutually Advantageous Industrial Co-operation

Sufficient stability, i.e. predictability and reliability of the basic terms and conditions of the co-operation project and of crucial elements in the economic, social, political and legal environment is necessary for the commitment of large resources of capital, of manpower and technology, of enterprise and economic development planning on a long-term and co-ordinated basis. The need for stability exists in traditional foreign direct investment, but also, or even more so, in the evolving forms of non-equity industrial co-operation. Here, the emphasis is turning away from "investment security" to "contract stability".

The existence - and the expectation - of instability gives rise to a series of defensive strategies used by both parties, imposing otherwise avoidable costs. Foreign enterprises undertaking industrial co-operation will attempt to protect their operations by insisting on excessive profits on a short-term basis in order to obtain a premium for the risks associated with perceived instability. Low equity/debt ratios are seen as instruments to reduce the risk component borne by the investor and shift it to the host country. These premiums for perceived risks are imposed on the host state and additional defensive strategy will but increase the costs of international industrial co-operation.

Foreign enterprises are required to contribute through their investment and co-operation to the economic development objectives of the developing host state. 1/ However, as long as there is no assured stability of the co-operation project's legal regime and its environment, it will be very difficult for any enterprise to commit itself to such long-term development goals. Finally, foreign enterprises employ - the greater their perception of risks, the more so - a set of defensive strategies to build a safety net. Most of these strategies negatively affect the bargaining of DCs and their ability to extract a maximum contribution to industrial development from the foreign partner: a system of built-in continued dependency of the host state on TNCs (through a continuous need for transfer of technology and managerial experience, access to international marketing channels, control over shipping and finance) is meant to deter DCs from revising once negotiated investment terms. Other strategies to reduce the scope for DC national economic sovereignty include: 2/

1/ Cf. e.g. para. 59,g,h of the Lima Plan of Action

2/ Cf. Moran, Copper in Chile, 1974, p. 153ff.

- collective action of an informal or formal character (e.g. investment consortia, involvement of banks and customers in the investment arrangement)

- internationally engineered dependence (e.g. foreign trust accounts to collect proceeds from the marketing of the investment project) and

- strategies to marshal international sanctions against recalcitrant DCs (e.g. publicity given to international arbitration awards, litigation in other countries subsequent to nationalization, measures aimed at the creditworthiness of DCs)

On the other hand, DCs have countervailing strategies which, though often not successful in maximizing developmental contribution from industrial co-operation, affect the international activities of TNCs: nationalizations, legislatively or administratively engineered revisions or encumbrances of an investment project's legal regime and financial feasibility. Such actions can impose considerable costs and losses on TNCs, but they often affect to a corresponding degree the host state in question, e.g. through a cut-off from international marketing and transfer of technology, a deterrent effect on future investment through additional risk margins required for perceived instability, or a reduced creditworthiness. Also, the strategy of confilict between investor and host state often leads to an escalation of defensive measures which is counterporductive to both parties' goals. A prime example is the escalation of TNC manipulations through the global corporate system (e.g. transfer pricing abuses, globally rather than nationally oriented investment strategies) and DC countervailing control strategies. The consequence is the establishment of increasingly more complex and all-embracing bureaucratic structures which attempt to cope with ever more sophisticated TNC strategies. This mutually generated build-up of bureaucratic systems results in costly time delays; in complication of project planning and implementation; in the exclusion of medium-sized enterprises, particularly from DCs not possessing the experiences and capacities to cope with complex investment regulations; in the diversion of large financial and human resources from industrialization efforts to feed the ever growing bureaucratic systems of host states and TNCs.

Stability is, accordingly, a decisive issue for industrial co-operation. Stability pertains to the narrower question of the ability of the DC and foreign partners to rely on terms negotiated between them. But it pertains as well to crucial economic, social and political conditions of the national and international environment of industrial co-operation. A narrow perception of investment security will often overlook that it is less the instability of an investment projects legal regime than the instability of major environmental factors which creates hindrances for long-term commitments. DCs have - because of their underdevelopment and vulnerable position in the world economic system - often little control over such destabilising external factors. The relevant analysis has hence to view the issue of stability from a global - and not just from a narrow legal - perspective.

All contributions to the present study aim at increasing the long-term stability of industrial co-operation, particularly the programme to bring DCs to a level of bargaining abilities comparable to that of their foreign partners and the programme to promote the evolution of a New International Industrial Development Law. The following subchapter focuses on one very controversial aspect of stability: stability of the terms and conditions negotiated and relied upon by host state and its foreign partners.

At present, the issue of stability is fraught with an unresolved controversy between ICs and DCs. This controversy on Third World efforts to obtain the power to revise - on the micro-level of contractual arrangements as well as on the macro-level of international arrangements - terms, conditions and institutions once established. The conflict between traditional international law concerning investment security versus the principle of national sovereignty over economic development characterizes the positions. This conflict is intensified by the perception held by many TNCs and home states of stability: complete unalterability of terms agreed upon or existing at the onset of a long-term investment project. The risk of obsolete or inappropriate terms is thus laid on the shoulders of the host state, of all actors the least able to control and carry the risks associated with rapid transition and to maintain such terms through the storms of change characteristic in societies engaged such transition.

This study rejects that the issue is the choice between investment security and national sovereignty. Stability is viewed rather as a dynamic concept which allows the co-operative relationship to be maintained through the unavoidable storms of change. The existence of a mutually advantageous relationship alone merits stability, not the individual terms. From social cybernetics we know that social systmes incapable of structural change are likely to perish. 1/ On the other hand, social systmes that possess some stability of their internal structure and are able to cope with external challenges through adaptation and revision have a considerable higher chance of development and survival. This ability to adapt may be termed "ultrastability" or "active stability". We employ here the notion of "dynamic stability". As a consequence, we have to search for methods and mechanisms which combine the requisite stability with adaptation and which institutionalize a continuous interdependence of the parties on the basis of mutual performances. Responsiveness to DC industrial development has to be combined with the requirements for stability of long-term

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1/ Cf. Deutsch, K. W., Nerves of Government, 1963, p. 214ff.; Klaus, Kybernetik und Gesellschaft, 1972, p. 17; Cadwallad The cybernetic analysis of change, in Etzioni/Etzioni (ed.) Social Change, 1964, p. 159.

complex and high-risk planning and co-ordination. It is the concept of "dynamic stability" which is meant to replace the stale conflict between investment security and national sovereignty and which is to service as a guiding concept for the methods and mechanisms elaborated below.

Furthermore, the study assumes that stability is not just a position of ICs confronting the antagonistic interests of DCs: Stability is, on the contrary, an important bargaining asset of DCs.

Socialist states have, for this reasons, placed utmost emphasis on co-operation stability enabling them to harness the potential of industrial co-operation to a considerable extent. 1/

Finally, stability can not be viewed as an exclusively North/South - and TNC - issue. Non-TNC actors of industrial co-operation, e.g. medium-sized enterprises, particularly from DCs, are much less able to spread, reduce, insure and shoulder the political and economic risks associated with international industrial co-operation than TNCs. The perception of instability is a factor which favours TNCs over DCs and non-TNC actors. Stability of industrial co-operation is hence to be viewed as a crucial issue to promote economic co-operation among DCs. There have been some attempts to tackle the stability issue in the South/South context. 2/ However, these attempts cannot equal the safety net erected by ICs in protecting the foreign investment of their enterprises. 3/ The instruments proposed in this study aim primarily at increasing actual and perceived stability in the context of policies promoting South/South co-operation and of the diversification of the agents of industrial co-operation.

1/ Cf. Ivanov, The State Monopoly of Foreign Trade in the USSR: The Experience and Conclusions of Interest for Developing Countries (The Case Study of the Soviet Machinery Import from the Western Countries), report for the Joint Study. This aspect has also been emphasized at the June 1979 meeting of Eminent Persons to discuss the Joint Study.

2/ E.g. the Inter-Arab Investment Guarantee Corporation; investment protection and promotion treaties between e.g. Afghanistan/Indonesia (1955); Egypt and Kuwait (1966); Kuwait and Iraq (1966).

3/ E.g. the investment protection treaties concluded primarily by the RG and Switzerland or the friendship, commerce and navigation treaties concluded by the US.

The first section below will deal with methods and mechanisms to increase the adaptive capacity of co-operation contracts, the second with the stabilising capacity; finally, a section will deal with institutional aspects to promote the requisite synthesis of adaptive and stabilising instruments.

5.2 Towards a system of adaptation in industrial co-operation contracts

Adaptation of the contractual structures for industrial co-operation can take place through a variety of methods. The necessity to equip long-term co-operation agreements with adaptation mechanisms is not a completely new phenomenon. Commercial interaction among western industrialised countries has required increasingly adaptive instruments to solve problems of long-term contracts and of the volatility of jointly undertaken projects. 1/ The same applies to East/West trade. 2/ Resolutions and recommendations from highly competent international organisations have repeatedly stressed that renegotiation clauses and procedures would be a suitable way to provide for increased responsiveness of investment agreements. 3/ The present study, hence, will explore specific issues and appropriate mechanisms of adaptation. The respective methods and mechanisms could become an important element in the proposed programme to support Third World negotiation abilities through model contracts and negotiation guidelines.

1/ Cf. Oppetit, L'adaptation des contrats international aux changements de circonstances, Clunet/Journal du droit international, 1974, p.794; Pasquel/Jehl/Sanson-Hermitte/Thomson, La relation du droit au futur, Contribution to the March 1979 Dijon colloquium "De l'Energie nucleaire aux nouvelles sources d'energie"; communications by Bernini, Holtzmann and others on Techniques for resolving problems in forming and performing long-term contracts, Communications for Working part IV, Proceedings of the Fifth International Arbitration Congress, New Delhi 1975.

2/ Cf. ECE Doc. TRADE/R. 373 of 31 August 1978; of particular interest and the rules for contract adjustment in the GDR's Code on International Economic Contracts at para. 42 and 295.

3/ Cf. UN, Impact of Multinational Corporations on Development and International Relations, op.cit. at p.38; Annual Report of the Secretary-General of ICSID to the Administrative Council, 1974. OPEC-Resolution XVI.90 of 1968, in 7 Int'l Legal Mat. 1183 (1968); the General Assembly (GA Res. 3202, SVI, in Art. V(6) has expressly decided that one of the five major objectives of a Code of Conduct on TNCs is "to facilitate, as necessary, the review and revision of previously concluded agreements". This has been taken up in the "Formulations of the Chairman" of the Intergovernmental Working Group on a Code of Conduct, Doc. E/C.10/AC.2/8 of 13 December 1978, p.4 where TNCs, in the absence of renegotiation clauses, "should respond positively to requests for ... renegotiation of contracts ... in circumstances marked by duress, or clear unequality between the parties or where the conditions upon which such a contract was based have fundamentally changed, causing thereby unforeseen major distortions in the relations between the parties and thus rendering the contract unfair or oppressive to either of the parties".

(1) Adaptation Mechanisms Through the Organisational Structure of Co-operation Contracts

Self-adaptive capacity can be increased by a shorter duration of co-operation contracts when a renewal or extension is made conditional on performance in forms of specified targets. Self-adaptation increases also to the extent that the legal regime of a project is less comprehensive, excessively detailed and rigid and leaves more to joint decision processes, the procedures of which are established through a framework agreement or through joint venture types of corporate organisation. 1/ To the extent that decisions over future operations are not exclusively and comprehensively governed in an overall contract - but to be made through procedures and committees established by the master or framework agreement there is more openness to bargaining at the various stages of project implementation. This break-down of initial, comprehensive negotiations into periodical bargaining processes allows the host state to articulate its gradually increasing bargaining power and industrial experience, in short: to obtain adaptation parallel to its industrial learning curve.

Also, the institutionalisation of quid-pro-quo packages increases adaptation, as each partner's performances can be tied to the other's throughout the contract's life. Performance can be tied to tax and other incentives so that a continuous process of give-and-take provides for adaptation.

(2) Adaptation and Dynamisation of Major Project Functions

Another method of injecting flexibility into the project's regime is the use of provisions which allow for an automatic adjustment of major project functions according to key external factors. Similarly, built-in change can be engineered through a pre-programmed gradual phase-in or phase-out of the parties share in or control over major project functions. The basic idea underlying these concepts is to generate a "dynamic project contract" which is able to transform itself in the course of time or in response to crucial environmental factors and thus to replace the road-block effect of rigidly drafted comprehensive agreements.

1/ Cf. for a model of quasi-corporate organization of joint decision and adjustment processes see the model contract on international industrial co-operation and the respective report "Gestion de la Co-operation" presented by Touscoz at the Nice Colloquium, June 1979, on International Industrial Co-operation Contracts.

In the context of financial issues between host states and investors, adaptation can depend on crucial external factors (e.g. inflation, commodity prices, currency risks, governmental market intervention), through indexation of export prices or taxes on imported industrial products or tax systems which provide for an increasing host state share or which are tied to an agreed upon rate-of-return criterium ("sliding taxes"). 1/ In the context of issues of ownership and control, a dynamism can occur through disinvestment programmes which increase national participation over time according to pre-established schedules and which serve as instruments of transition from foreign to national control. In the context of developmental obligations (localization of linkages, obligations related to forward and backward integration), dynamization can be stipulated through schedules which gradually increase the respective developmental obligations of foreign investment. 2/ Such gradually increasing obligations prepare the investor and the DC for the problems associated with developmental contributions of an investment project but do not overburden the partners with too many obstacles to be faced at once.

(3) Mechanisms for Renegotiation

Renegotiation of long-term agreements is a most sensitive issue in present controversies, particularly as renegotiation appears to replace the traditional form of assertion of national sovereignty through nationalization. 3/ Of particular importance would be, therefore, the design and the promotion of appropriate provisions and procedures for the adaptation and renegotiation of long-term contracts. This approach seems to fit in the synthesis of stability and adaptation required for "dynamic stability". Such provisions and procedures would have to be worked out through the UN programme to support Third World bargaining and promoted through model contracts and negotiating manuals. The renegotiation provisions and procedures would have to be designed for the various forms and sectors of industrial co-operation.

1/ Cf. Wälde, Financial Arrangements between Host States and TNCs, UNCTC Roundtable on Negotiations with TNCs, April 1978.

2/ Cf. UN, TNCs in World Development: A Re-Examination, op. cit. at p. 77ff.

3/ Cf. for analysis of renegotiation practices and provisions in investment agreements - Wälde, Revision of Transnational Investment Agreements, 10 Law.Am.(1978) 265.

a) Contractual Renegotiation Provisions

Contractual renegotiation provisions would provide:

- a definition of the event triggering renegotiation: material change of fundamental circumstances; [1] substantial change in comparable conditions, world market prices, or financial yield, defined by a target rate of return; non-compliance with the obligations imposed by authoritative international Codes of Conduct and comparable instruments;

- a period of time, following which renegotiation could take place periodically. Periods of time for renegotiation could also be defined by using such criteria as recoupment of initial investment plus a stipulated return on repayment of outstanding loans.

- the scope of renegotiation, renegotiation could cover the whole agreement or only certain key provisions.

- the standards to be used by the parties in renegotiating, e.g. fairness; sharing of unexpected risks; target rate of return; comparable terms; account of the risk taken; economic feasibility of the project under revised terms and the partner's competitive position; standards set by international organizations or through bilateral intergovernmental agreements. [2]

b) Renegotiation Procedures

There is a variety of procedural arrangements for channeling renegotiation pressures into cinciliatory and semi-juridical procedures. The parties could, for example, provide for a bilateral renegotiation procedure with the possibility of appeal to the highest levels of each sides. [3] Parties outside the contractual context could intervene if a deadlock situation persists. On the basis of an inter-governmental agreement,

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1/ Cf. the "Formulations of the Chairman", cited supra.

2/ Cf. US Renegotiation Act of 1951, 50 USC Appx. 1211-1233; US Armed Services Procurement Regulations, 32 CFR para. 3-308 (1977); OPEC Res. XVI.90 of 1968, op. cit.

3/ In this context, it would be useful to establish a code of ethical behaviour for negotiation and renegotiation procedures, i.e. determining what practices (threats and pressures) would be unacceptable and what practices would be acceptable, Cf. Vagts, Coercion and Foreign Investment Rearrangements, 72 AJIL (1978) 17, 34.

representatives of both states could meet to find an appropriate solution. [1] Third-party intervention could also consist of a conciliation proceeding [2] with a conciliator to make non-binding proposals for contract adaptation. Finally, third-party intervention could be fashioned in the form that the third party would be empowered to render a binding decision adapting the contract. [3]

c) A Facility for Contract Adaptation (FCA)

It seems that a neutral and mutually acceptable institutional facility to adapt a co-operation contract upon the parties' request and corresponding to contractual provision, is in the interest of both partners. Such a facility should be attached to the proposed System for Conflict Resolution. It would develop further the approach adopted by the ICC rules for adaptation of contracts and by the former US Renegotiation Act. [4]

Such a facility would, upon referral by one of the parties subsequent to a corresponding contractual agreement, appoint a neutral third person from a list of experts. This third person would conduct, in accordance with respective rules to be established, a procedure for contract adaptation with the participation of both parties. He would issue non-binding recommendations for contract adaptation; if so empowered, he could also issue a legally binding adaptation. In doing so, he would rely on standards stipulated by the parties in their contract or standards to be elaborated within the context of the proposed bargaining programme and by the Commission for Industrial Development Law. Appropriate safeguards for the party which does not agree with an adaptation could be included, e.g. the right to terminate the contract with appropriate notice.

1/ This is a procedure often employed in East/South intergovernmental industrial co-operation.

2/ Cf. the new ICSID rules for an Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings, Washington, DC., September 1978;

3/ E.g. para. 42 and 295 of the GDR Code on International Economic Contracts; see also para. 315 of the Civil Code of the Federal Republic of Germany and the "Vertragshilfegesetz" (Law on Contract Adjustment Assistance).

4/ Cf. ICC publication No.326 of 1978. see also the US Renegotiation Board 1217 US-Code (Washington, D.C. 1977) and the respective provisions of the GDR Code on International Economic Contracts Commented on by Strohbach, in his report for the Joint Study.

The proposed facility for contract adaptation would provide a solution for parties that cannot agree on another procedure or another institution; it could serve as a point of reference in inter-governmental agreements. It would not exclude the competence of other institutions, but through proper fashioning of the procedural and substantive rules and through its composition provide a middle ground for negotiations between DCs wanting exclusive national jurisdiction and TNCs favouring submission of disputes only to established international arbitration tribunals. The institutional setting of the facility for contract adaptation would tie it into the proposed UN system for conflict resolution (infra.).

5.3 Towards Dynamic Stability of Industrial Co-operation Contracts

In addition - and extricably linked - to the methods and mechanisms directed at increasing the adaptive capacity of industrial co-operation contracts is the need to improve effectiveness of instruments related to co-operation contract stability, specifically in South/South agreements. They only are practical when they are packaged with mechanisms designed to adapt contractual arrangements to developmental needs. Stabilization also has to avoid the conflict costs of the confronting strategies of nationalization and risk margins and economic boycott. Stabilization should hence be complement adaptation and be linked to developmental performance. In particular, one has to seek mechanisms of stabilization which increase Third World bargaining abilities. 1/

(1) Stabilization Provisions

Investment contracts often contain so-called "freezing clauses" which establish the legal framework for investment for up to 20 or 30 years. 2/ The validity of such clauses is questionable. An appropriate compromise would be to recognize and even sanction stabilization clauses with reasonable limits. Stabilization provisions should be recognized to the extent that they are legitimate for long-term and high-risk investment, that they are balanced by adequate adaptation provisions and that they are conditioned by binding commitments for developmental performance. Freezing clauses going beyond these limits should be considered contrary to international public policy and hence void. It appears useful to elaborate acceptable model stabilization clauses with adaptation provisions. They could be tied to commitments

1/ Cf. the emphasis given by Socialist state in East/West co-operation to stability as a major factor of bargaining power, see report by Ivanov for the Joint Study, op.cit.

2/ Cf. Weil, Les clauses de stabilisation ou d'intangibilité insérée dans les accords du developpement economique, in Mélanges offerts à Charles Rousseau, 1974, 301ff; critically Brown, Choice of Law Provisions in Concessions and related contracts, 39 Mod.L.Rev. 6(1976). It has also been asserted that stabilization clauses are counter the ius cogens of economic independence and hence void, see Ninth Argentine Democratic Lawyers Association, July 1970.

for developmental performance, e.g. to a commitment to obtain a certain degree of domestic processing of natural resources or of foreign exchange earnings. Stabilization guarantees within reasonable limits and in a situation of balanced bargaining power could be made effective by compensation bonds, in which the host state would give the investor - or the home state through an intergovernmental agreement - a bond fixing the minimum amount of compensation to be paid in case of nationalization or of a material breach of contract. These bonds would have to be paid upon the decision of a proposed centre for conflict resolution as proposed (infra).

(2) Stability Through Streamlining Administrative Procedures

In response to the challenges created by TNCs, host countries have established often highly complex bureaucratic procedures which can prove mutually costly and combersome and which often seem more to add administrative costs than to extract developmental contributions. Such administrative complexities exercise a roadblock effect particularly in discouraging involvement by middle-sized enterprises from developing countries [1/] because they are less able than TNCs to cope with bureaucratic complexities. The negative effect of bureaucratic obstacles on industrial co-operation has repeatedly been emphasized by business concerns. [2/] It has been found that it is less the regulation of foreign investment than the bureaucratic obstacles and the unpredictability of administrative decisions which impede industrial co-operation. [3/] The delays and costs produced by overly complex bureaucratic procedures are suffered by both partners. The procedures often serve more to encourage bureaucratic growth than to provide effective control. [4/] Accordingly, utmost care should be devoted to devise administrative procedures that are effective and do not create unwanted obstacles. It seems that an efficient administration often will be a better investment incentive than tax incentives which frequently imply a loss of revenue without corresponding stimulating effect. It is suggested activities be undertaken to assist DCs in setting-up efficient administrative procedures to deal with international industrial co-operation.

1/ Cf. Bhandari, UNCTAD Doc. TD/B/C 71/7 of 18 September 1978 at p.19.

2/ Cf. a meeting held by the Joint Study group in February 1979 in Bonn with representatives of West German Companies; meeting with BIAC/OECD, Paris, March 1979.

3/ Vaitsos, The Role of TNCs in Latin American Economic Integration Efforts, report prepared for UNCTAD, op.cit., emphasizes the importance of the stability of rules once established as a reliable basis for business decision-making.

4/ Cf. Girvan, Corporate Imperialism, 1976.

It is suggested that a procedure of comprehensive and accelerated authorization for industrial co-operation operations would be most helpful. One agency should be empowered to represent various national authorities (e.g. tariff, tax, planning, commerce, central bank authorities) in negociations with foreign enterprises. The central agency would consider formal but simplified applications from foreign enterprises. After discussing the proposals with the appropriate national authorities (e.g. tariff, tax, planning, commerce, central bank), the agency would reject or accept the proposal or ask for modifications. The agency would be required to take action within a specific time period. If no decision were reached within this period, authorization would be granted automatically. Similar procedures, also featuring the automatic approval system, would be instituted during project implementation and operations, forcing DC authorities to coordinate their action in a rapid and efficient manner. Such systems of comprehensive authorization have been used in ICs for complex administrative decisions (e.g. approval of nuclear power plants. Applied by DCs, they would reduce time delays, bureaucratic complexities and the foreign partner's burden of the intricacies of the national administrative system.

(3) Stability Through Inter-Governmental Mechanisms

Inter-governmental agreements have been used by ICs to promote their concept of investment security (supra). It appears that commitments of DCs for stability always should be accompanied by home state commitments for the co-operating enterprise's developmental performance. This concept of a package between stability and performance will be discussed elsewhere (infra). In addition, there are various mechanisms to be established on the inter-governmental level which contribute to the evolution of universally accepted rules for industrial co-operation, i.e. a New International Industrial Development Law. If supported by appropriate institutions - as the proposed UN Commission for Industrial Development Law and a balanced system of international arbitration - such inter-governmental action contributes to greater stability in favour of all parties participating.

In the North/South context there seems to be little need for additional mechanisms of investment insurance to promote stability. National schemes for investment insurance and bilateral investment protection treaties [1/] seem to offer sufficient coverage for investors from Northen ICs. For this reason, several attempts to set up multilateral investment protection schemes under the auspices of the IBRD or the OECD, have failed. However, investment flows and industrial co-operation projects involving enterprises from DCs are at a considerable disadvantage compared to

1/ Cf. Vagts, Prospects for a multilateral investment insurance agency, report for UNCTAD, May 1978.

well protected North/South flows. This is of particular concern as enterprises from DCs are more sensitive to political risks than large TNCs. Accordingly, there is a need for insurance and guarantee schemes covering political risks of industrial co-operation among DCs. Proposals rely particularly on the successful example of the Inter-Arab Investment Guarantee Corporation (IAIGC), oriented at insuring investment of medium size flowing from one Arab DC to another. 1/ The IAIGC has functioned as a regional DC system of investment stability geared exclusively to control, origin and destination of investment. New, DC - oriented systems should also help channel financial flows from petroleum-producing DCs to other DCs. Up to now, these funds have mostly travelled into investment opportunities of Western ICs being more capable of assuring the necessary stability could reduce investment risks.

5.4 Institutional Aspects to Promote Stability

It is hence suggested that a system of regional industrial investment insurance schemes (IIIC) be established with through promotional, financial and operational assistance of UN bodies. The schemes could be attached to the respective regional development banks or the UN Regional Economic Commissions and principally follow the model of the Inter-Arab Investment Guarantee Corporation. These regional schemes would insure investment and quasi-investment rights in industrial co-operation, between or among participating countries within the region, and, as appropriate, other countries as well. Risks covered would correspond to the traditional investment risks, i.e. expropriation and inconvertibility of returns, but also include risks associated with the unjustified intervention into the contractual system of rights and obligations of co-operation contract. Participating countries would supply money and guarantees, which would be transferred to projects by the regional insurance schemes acting as a fiduciary and trustee.

The proposed regional investment insurance schemes which would go considerably beyond the futile efforts of multilateral investment insurance like the IIIA, would have two related advantages. First, intraregional investment and co-operation would be furthered; and secondly, South/South co-operation in general could be more effectively supported. To serve these aims more fully, the regional insurance schemes would work together with investment promotion bodies, activating the potential for co-operation among member countries. These schemes would lead to a better matching

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1/ Cf. UNCTAD, Economic Co-operation and Integration among DCs, Doc. TD/B/609/Add.1, Vol. V of 24 August 1976, at p. 106. These schemes - such as the US OPIC or the FRG's investment insurance scheme - increasingly provide insurance coverage also for non-proprietary rights such as contractual rights and thereby take into account the evolution of non-equity forms of long-term industrial enterprise co-operation.

of investment stability and performance. Participating countries would among themselves agree to a certain pattern of investment treatment and to performance goals. This could be co-ordinated with efforts at regional harmonization of investment and co-operation terms.

The regional insurance schemes and existing national investment insurance schemes of ICs could co-operate and co-ordinate their activities under the umbrella of a global investment insurance system (IIS), whose aim should be to harmonize insurance to avoid overlap or distortion of investment conditions caused by differences in insurance conditions. In addition, an IIS would allow a deeper analysis of insurance needs and coverage of investment in DCs which will better reflect DC interests. By creating a forum for national as well as regional insurance schemes, ICs may preserve their national insurance systmes, while DCs may exert more influence on the conditions of insurance to be applied to DC investment. IIS would issue recommendations to member countries on technical questions. It may also propose a model insurance contract to members which would attempt to accommodate the concerns of DCs and investors alike. By embarking on this course, IIS may avoid pitfalls which have caused other multilateral investment insurance proposals to falter in the past. It would not materially affect operations of presently existing investment insurnce programmes in the short run. But gradually, IIS members could induce changes in these systems by persuasive action in response to demands of the majority of members. 1/ Arising disputes could be referred to regional arbitration centers of the proposed SRIC-system. The regional investment insurance corporations could be incorporated under the proposed regional corporate statute for regional joint enterprises (infra).

1/ Cf. for an extensive discussion of the proposal for regional industrial investment insurance schemes, their organization, financing and operations and the differences relating to past efforts the report by Stockmayer (1979) for the Joint Study.

CHAPTER 6: CONFLICT AVOIDANCE THROUGH CONFLICT RESOLUTION MECHANISMS

6.1 Methods for Conflict Resolution as a Contribution to Conflict Avoidance and Co-operation Stability

Conflicts arise necessarily in the context of industrial co-operation, in proportion to the complexity, the long-term orientation and the divergent interests, levels of development and heterogeneous attitudes of the partners. Conflicts can arise out of the interpretation of a contract, particularly if the contract does not provide for unforeseen events; in that case, conflict resolution may have to provide for gap-filling.[1/] Conflicts may also arise out of matters requiring primarily technical expertise and fact-finding.[2/] They can arise out of alleged non-performance of a partner's obligation and claims for restitution and damages. Finally, conflics may arise out of one party's demand for renegotiation or adaptation of a contract. This can happen particularly in the case of long-term contracts and in the case of a fundamental change of crucial external or internal circumstances.

The resolution of these conflicts is necessary to make industrial co-operation viable and effective. Procedures, institutions and criteria for resolving conflicts have to differ, according to what type of conflict is at issue. Interpretative conflicts centered on gap-filling require primarily legal expertise; technical and fact-finding disputes require technical abilities; conflicts for non-performance need a carefully balanced conflict resolution mechanism. This is particularly the case for conflicts over renegotiation demands. Sometimes expediency and practicality are of utmost importance (e.g. conflicts of a technical character during project planning and implementation), while other conflicts (e.g. claims for damages for breach of contract) have to be settled through careful legal analysis.

The methods used for solving such differences certainly must be practical and efficient, but they are inextricably linked to the issue of stability. If a conflict can be solved under neutral and balanced procedures accepted by all parties, the partners will have confidence in the stability of terms negotiated for long-term

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1/ Cf. the contribution by Holtzmann and Bernini to the 1975 New Delhi Congress on International Arbitration, op.cit; Strohbach, Improvement of Existing Mechanisms for Dispute Settlement, Berlin 1979, report for the Joint Study.

2/ e.g. determination of acceptable at-arm's-length conditions; quality questions; feasibility study disputes.

commitments. Co-operation stability is hence linked to a suitable method for solving differences. But also, an acceptable mechanism for dispute settlement responsive to DC industrialisation can be an incentive for a host state to rely less on its sovereignty prerogative and choose procedures for solving conflicts which are less costly in terms of conflict escalation. Both parties' confidence in the project is enhanced if some mechanism is available to induce compliance with the obligations stipulated. For this reason, mutually acceptable and effective methods for conflict resolution are not, as often assumed only in the interests of investors: Algeria has emphasised the need for methods of international arbitration which allow a DC host state affected by mal-performance of contrator obligations to find an effective recourse and sanctioning system to enforce non-performance claims. 1/

Methods for conflict resolution have to be seen primarily as instruments for conflict avoidance. Parties which have agreed to specific methods for conflict resolution, be it conciliation, national courts or international arbitration, will anticipate the results and orient their behaviour accordingly. Often they will seek a mutual settlement without outside intervention, even if such a method is stipulated. That arbitration clauses are often not invoked is not an indicator of their ineffectiveness, but demonstrates that the contractual system of conflict resolution induces conflict avoidance. 2/

Conflict resolution mechanisms through national or international arbitration and judicial decision can fulfil another important function: application of law often evolves into law making. This is particularly so in the context of North/South or South/South industrial co-operation, where often no appropriate rules exist. Accordingly, conflict resolution can become a mechanism for the evolution of international industrial development law. 3/

1/ Cf. Mémoire présenté par l'Algerie à la Conférence des Souverains et Chefs d'Etats des Pays Membres de l'OPEP, Algiers, March 1975, p. 211, 227; (it is interesting to note that this authoritative memorandum recognises some form of international arbitration as an important instrument for DCs affected by contractor mal-performance but demands a revision of the existing system to make it more responsive to the specific needs of DC industrialisation.

2/ Cf. the title of the comprehensive study be Delaume, Transnational Contracts, A Study in Conflict Avoidance, 1976.

3/ Cf. Fouchard, Arbitrage et Droit International du Développement, Actes du Colloque International, Algiers 1976.

This neglected function of conflict resolution, has been overshadowed by the tendency of international arbitration tribunals to give priority to traditional international law widely rejected by DCs. 1/ Acceptable and effective methods of conflict resolution are hence necessary. They have to be practical, i.e. suited to the specific situation and the type of conflict at issue, and they have to be responsive to the specific needs of Third World industrialization. They should be balanced, acceptable to the parties concerned and apply legal and technical standards which conform with the principles of an International Industrial Development Law.

6.2 Existing Practices and Institutions: An Evaluation

At present, the prevailing method of settling disputes in international commercial transactions among Western ICs is through international arbitration. 2/ International arbitration takes place through specialized arbitration bodies (e.g. for the commodities or shipping trade), and national arbitration bodies but particularly through the extensive Arbitration Court of the International Chamber of Commerce. 3/ The ICC has also issued rules for contract adaptation 4/ and has established a Centre for Technical Expertise 5/. A condition for the success of ICC arbitration among ICs seems to be the considerable experience and the efficient institutional framework which is provided by the Court of Arbitration and its secretariat. In addition, ICC arbitration is promoted through the affiliated chambers of commerce. Another condition has been the relative homogeneity of business attitudes and expectations which has developed over the years and has resulted in considerable acceptance of the procedures and rules applied by the ICC arbitration tribunals. Acceptance can also be credited to the degree of expertise expected and the neutrality of procedure. Cost efficiency and expediency are secondary.

1/ Cf. Several major cases generally rejecting host state claims for national sovereignty over economic development, e.g. Goldfields, Lena, I Annual Digest of International Law Cases, nos. 1 and 258 (1930); Societa Rialet, VIII Recueil des Decisions des TAM 742 (1929); Saudi Arabia vs. ARAMCO, 27 International L. Rep. 272 (1958); Ruler of Qatar vs. International Marine Oil, 20 International L. Rep. 534 (1953); Petroleum Development vs. Sheikh of Abu Dhabi, 18 International L. Rep. 144 (1951); Saphire Case, Annuaire Suisse de Droit International 273 (1952); TEXACO/CALASIATIC vs. Libya, 104 Journal de Droit International 350 (1957); some modification can be observed in a recent arbitration arising out of the context of the 1971 Libyan nationalization (BP. vs. Libya, arbitral award by G. Lagergren), (1973), to be published;

2/ Cf. for a comprehensive survey Schmitthoff (ed.), International Commercial Arbitration, vol. I/II, 1974, to be published;

3/ Cf. ICC-Doc. 301 of 1977, The International Solution to International Business Disputes; summarized versions of important arbitral awards are published on a regular basis by Derains in Journal du Droit International, as recently as 1978, at p. 976ff;

4/ Cf. ICC Doc. 326 of 1978;

5/ Cf. ICC Doc. 307 of 1977.

In socialist states' commericial transaction, arbitration has become the almost exclusive method of solving differences. Attached to the chambers of foreign trade or of commerce of all members of the CMEA are highly speicalised courts of arbitration with rules and lists of arbitrators. These bodies appoint arbitrators and administer arbitration. Harmonisation of arbitration procedures, enforcement and recognition rules has been an important part of the CMEA economic integration effort. 1/ The extensive regulation of arbitration seems to give it an intermediate position between traditional arbitration and national courts' jurisdiction.

In the contert of East/West trade, arbitration has taken on a special significance, because the Final Act of the Helsinki Conference in 1975 has expressly endorsed arbitration for commercial contracts and for industrial co-operation contracts as an effective method for solving differences. 2/ Socialist enterprises are reluctant to accept ICC arbitration, as they perceive the ICC as an organisation reflicting the interests of its member firms and national institutions. In commercial transactions, general conditions of the respective partners often stipulate either the Socialist states national arbitration courts or the ICC arbitration. In more complex contracts, arbitration is mutually accepted in a neutral center (Helsinki, Stockholm, Vienna) or at the seat of the defendant. ECE and the new UNCITRAL arbitration rules are often stipulated along with a specific agreement on an appointing authority (cf. Strohbach, op. cit.). Finally, discussions are being held for a joint arbitration facility with a system of presidency rotation between western and eastern ICs.

In East/South relations, dispute settlement is often undertaker through direct state involvement via governmental representatives; sometimes, intergovernmental consultations will be instituted only after inter-firm conciliation and arbitration proceedings have failed. 3/

1/ Cf. the Convention of Settlement by Arbitration of Civil Law Disputes Resulting from Economic, Scientific and Technical Co-operation, Moscow, 26 May 1972; Uniform Rules for Arbitration in the Arbitration Courts at the Chambers of Commerce of the CMEA Countries, 1974. The uniform rules for arbitration do not apply directly, but are the binding model to which national arbitration rules were adapted in 1975. Accordingly, conflicts encounter in all CMEA member countries a basically uniform type of arbitration. Some countries, e.g. Poland and the GDR, have established specialised joint arbitration bodies for maritime disputes. For an extensive analysis see Strohbach, Improvement of Existing Mechanisms of Dispute Settlement, Berlin, March 1979, report for the Joint Study.

2/ Cf. Naryshkina, Arbitration and Technology Transfer Serve the Cause of International Industrial Co-operation, contribution to the 1978 Mexico International Arbitration Congress.

3/ Cf. Bratus, Arbitration and International Economic Co-operation, report to the 4th International Arbitration Congress, Moscow 1975; Boguslavsky, Legal Aspects of Industrial Co-operation between the Soviet Union and other CMEA Member Countries and the Developing Countries, Moscow, 1979, report for the Joint Study.

The most controversial area of conflict resolution seems to be the North/South dimension; in the South/South dimension a sufficiently developed system of arbitration does not exist. TNCs consistently seek to obtain DC submission to international arbitration bodies, primarily to the ICC's court of arbitration and the World Bank's International Centre for Settlement of Investment Disputes (ICSID) and its attached facilities for conciliation, arbitration and fact-finding proceedings. 1/

TNCs seek from existing international arbitration bodies principally safeguards for favorably negotiated investment terms through some measure of international sanctioning (e.g. publicity of the award, affect on the creditworthiness and reputation of reluctant and non-complying DCs) or the application of legal principles geared to investment protection. 2/ The insistence of TNCs and their respective home countries on international arbitration and traditional international law for conflict resolution has met stiff resistance by DCs. Such resistance is expressed particularly in international fora, where DCs are capable of taking a stronger position through collective action; it is also the core of considerable controversies concerning major instruments of the NIEO. 3/

On the level of project contracts, there is a definite trend away from international arbitration in areas such as petroleum where DCs have developed considerable bargaining power. In other areas, such as transfer of technology and particularly in loan agreements, non-national arbitration is still the rule. 4/ DCs'reluctance is based on their perception of national souvereignty as a defense against their unilateral dependency on ICs and TNCs. 5/ The prevailing arbitration institutions are

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1/ Cf. for the operations of the ICSID, Broches, Arbitration under the Auspices of the ICSID, Seminar on International Commerical Arbitration, Madrid 1978; ICSID annually reports on new developments; up to now, about 9/10 cases have been brought before ICSID, of which several were withdrawn after settlement had been reached between the parties. The ICSID Convention has so far been ratified by 71 states. Latin American states, Algeria, Libya, Tanzania, the Middle Eastern states with the exception of Kuwait, Eastern states with the exceptions of Yugoslavia and Rumania and Canada have not participated.

2/ Cf. it is interesting to note that commentators from differing views come to the same conclusion as to the principally defensive function of international arbitration, see Schmid, Arbitration under the Auspices of the ICSID, 17 Harvard International Law Journal 90 (1976); Benchikh, e.g. Arbitrage dans les contrats entre entreprises transnationales et les pays sous-développés, Report for the Joint Study 1979, Algiers,1979.

3/ e.g. the dispute settlement provisions in GA. Res. 3201, 3202, S-VI; dispute settlement is at present a still unresolved issue in the negotiations for Codes of Conduct on Transfer of Technology and on TNCs, cf. UN Doc. E/C.10/AC.2/8 of 13 December 1978, at §§ 54, 55; UNCTAD Doc. E.75.II.D.15 at p. 61.

4/ Cf. Waelde, Negotiating for Dispute Settlement, Denver Journal of International Law and Policy 7, 33 (1977).

5/ Cf. Benchikh, op. cit.

often regarded ith distrust, because they are said to represent the interests and attitudes of the institutions with whom they are affiliated, e.g. the IBRD and the ICC.[1/] Technical elements, such as costs, languages, place and procedural rules, are considered to ignore the speicific weaknesses of DCs. [2/] The legal standards and the arbitration concepts applied by the arbitrators are perceived to reflect a bias in favour of the capital - and technology-exporting countries and not responsive to economies engaged in a process of accelerated transition with institutional weaknesses. [3/]

On the other hand, in DCs it is frequently recognised that a revision of the present methods and mechanisms of arbitration could eliminate the "roadblock" effect of international arbitration on economic development [4/] and create a procedure which would be suitable for DCs, afford them proper protection against mal-performance and provide for the kind of "dynamic stability" which is necessary for mutually advantageous co-operation. [5/]

Recently some DCs have, submitted to arbitration procedures, when national law is applicable and arbitration takes place within the host state ("localisation of arbitration"). [6/] As for the applicable law and the legal and technical criteria to be applied by arbitration tribunals, ICs and TNCs insist on traditional international law, which is geared to provide protection to capital - and technology - exporting countries, DCs on complete national jurisdiction and the exclusive application of national law. [7/] On the project contract level, DCs with stronger bargaining

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1/ Cf. Strohbach, op. cit.

2/ Cf. Asian-African Legal Consultative Committee, Report on the 15th Session, 1974, p. 119.

3/ Le Roy, et. al. contribution to the Dijon Colloquium in May/June 1979, op.cit. analysing the inappropriateness of western legal concepts to many issues of development; Dunshee de Abranches, Institutionalisation and Universalisation of Commercial Arbitration: The Role of DCs, contribution to the 1978 Mexico International Arbitration Congress, has emphasised that DC acceptance of international arbitration methods is conditioned upon a revision of the prevailing methods; a parallel call for suitable amendments to arbitration procedures which "at present are onesided and unfavourable to DCs" has been voiced by Bnandari, report prepared for UNCTAD, Doc. TD/B/C.7/17 of 18 September 1978, at p. 42.

4/ Cf. Fouchard, Algiers 1976, op.cit.

5/ See the Algerian memorandum to the 1975 OPEC Conference, op.cit.; Bhandari, op.cit.; Dunshee de Abranches, op.cit.; the Asian-African Legal Consultative Committee is at present studying ways to improve and adjust arbitration methods to DC problems and requirements.

6/ OPEC Resolutions and ANCOM decision 24, while strongly disfavouring non-national arbitrattion, are not opposed to national arbitration arrangements, see OPEC Res. XVI.90 of 1968; ANCOM Decision 24 has been reprinted in 8 International Legal Materials 911 (1969).

7/ Cf. the NIEO resolutions and the on-going negotiations for Codes of Conduct.

power increasingly insist sucessfully on the exclusive application of national law. This is particularly relevant when freezing clauses deny host state demands for renegotiation. 1/ However, older agreements or agreements concluded in areas of reduced DC bargaining power, still refer to "international law", "generally recognised legal principles", "legal principles recognised by civilised nations" or, particularly in the case of loan agreements, to the law of the home country. 2/

However, there seems to be also a tendency to stipulate substantive legal rules for an eventual arbitration procedures. As far as technical criteria (e.g. Accounting principles) are concerned, it has been recognised that these criteria are not neutral, but can reflect a systemic bias for prevailing modes of business among ICs. Accordingly, there have been attempts, in investment agreements and the UN Group of Experts on International Standards of Accounting, to develop technical criteria and standards oriented specifically toward DCs' requirements. 3/

Recently, UNCITRAL has drafted new arbitration rules which were recommended by the UN General Assembly. 4/ These rules have been adopted by several arbitration institutions, particularly by the regional arbitration centres established by the Asian-African Legal Consultative Committee. However, these rules are fashioned to govern ad-hoc arbitration; they provide neither for an institutional form of arbitration nor for procedures for an appointing authority. But they are useful rules to govern the procedural element of international industrial arbitration.

The evaluation of the present practices of conflict resolution yields several results:

1/ Cf. Brown, Choice of Law Provisions, 39 Mod. Law Rev.6 (1976); Suratgar, Considerations Affecting Choice of Law Clauses, 2 Indian J. International Law. 273, 283 (1962); Date-Bah, The Legal Regime of Transnational Investment Agreements, 15 J. African L. 241 (1971); Ssekandi, Contracts between a State and a Foreign Private Company, 2 E. African LJ 281 (1966); compare on the other hand the statement by Dupuy, the sole arbitrator in the TEXACO/CALASIATIC case and J.F. Lalive, the respective counsel in the case, 104 Journal du Droit International 350 (1977) and at p.319.

2/ Df. Delaume, Transnational Contracts, op.cit., at chapter VI.;

3/ Cf. UN Doc. E/C.10/33 of 1977.

4/ Cf. UN Doc. A/CN.9/170 of 11 May 1979

(i) There is a need for new mechanisms of arbitration, which are not rejected by DCs and which are at the same time acceptable to foreign enterprises.

(ii) Several new trends in arbitration, particularly the method of localising and regionalising arbitration procedures and of creating legal and technical standards which are geared specifically at the problems of DCs should be developed further and made applicable to arbitration.

The underlying concept should not be an attempt to replace effective and useful mechanisms, but of adding a greater variety of institutional mechanisms and filling the gap between DC reluctance and TNC insistence. Parties to co-operation contracts should hence have a large number of options available. Such new mechanisms should be particularly geared to disputes arising out of the context of South/South co-operation. Accordingly, modified and new institutions and procedures could develop the conflict avoidance function of arbitration and contribute to stable and mutually advantageous industrial co-operation. Arbitration mechanisms should also be seen in their law-making function and be oriented at International Industrial Development Law. However, they should not be directed at providing a mandatory, global judiciary - thus be unacceptable to DCs with a strong tradition against any form of non-national arbitration Calvo-principle. Consistent with the tool-kit approach, they should provide a variety of solutions to accommodate differing interests and attitudes.

6.3 New and Improved Methods and Mechanisms for Conflict Resolution

Improvement of conflict resolution has to build on the deficiencies and strongly current practice.

On the level of project contracts, the present trend towards localisation of conflict resolution, towards elaboration of legal and technical standards which are appropriate for industrial co-operation with and among DCs should be promoted. Specifically, this would imply that the proposed UN programme to support Third World bargaining and to promote the evolution of a new International Industrial Development Law should include the design of model clauses for conflict resolution appropriate for the various situations and policies of DCs. In the long-term, this could evolve into uniform terms for conflict resolution in international industrial co-operation. Specific attention should be paid also to the elaboration of new or the modification of existing technical criteria to increase their responsiveness in DC development. The existing UNIDO capacities in the preparation of feasibility studies and the proposed expansion of these capacities could be linked, in appropriate co-operation with other appropriate UN bodies, to such efforts.

On the evel of institutional arrangements, the evaluation of existing practices has demonstrated the need to increase the institutional options available by arbitration institutions which are geared specifically to DCs. Accordingly, present trends to establish regional arbitration centres such as done by the AALCC should be supported. More concretely, the following proposals for action can be made:

(i) National Arbitration Centres

For many host countries, only national arbitration is acceptable. Efforts to render such arbitration centres sufficiently expert and experienced so as to make them acceptable to foreign enterprises should be encouraged. The UN system could provide, upon request, technical assistance, co-operation and co-ordination. 1/

A number of countries and arbitration arganisations 2/ are already rendering technical assistance for setting up national arbitration centres in DCs, be it through ad-hoc expert advice, through co-operation agreements or through participation in respective international arbitration bodies. It seems that the UN system could assume an important role, particularly related to arbitration problems directed specifically at industrial enterprise co-operation. Assistance could be forthcoming from UNIDO, UNCTAD and UNCITRAL. The assistance should render national arbitration centres capable of dealing with conflicts requiring contract interpretation and to those relating to claims for non-performance, to gap-filling and contract adaptation and to technical issues.

(ii) Regional Arbitration Centres

Of particular interst seems to be the establishment of regional arbitration centres. Such centres could be an acceptable forum to articulate DCs' concepts as outside the countries which are parties to a dispute. Support and co-operation should be given efforts such as undertaken by the AALCC. Regional arbitration centres could be attached to the UN Regional Economic Commissions, which would give them more weight and acceptability. They could also be set up on a bilateral basis. 3/ They could apply UNCITRAL procedural rules, if necessary, in a modified form. Their regional character and their attachment to the UN system would distinguish them from existing institutions.

1/ Cf. the respective proposals in the reports by Strohbach and Benchikh for the Joint Study.

2/ Cf. Strohbach, op.cit.

3/ Cf. the joint arbitration board between Poland and the GDR at Gdynia for Maritime Disputes.

In addition, such regional arbitration centres should establish the following specialised facilities to take charge of problems characteristic of long-term industrial co-operation:

- A facility for Contract Adaptation and Gap-Filling

  Such a facility would, according to established procedural rules and substantive standards, upon referral by the parties, provide a service of contract adaptation and filling of gaps (as explained supra);

- A Facility for Technical Expertise and Fact-Finding

  Technical disputes are increasingly important in industrial co-operation. Also technical rules and criteria are by no way neutral and often reflect systemic biases. Accordingly, the proposed facility should draw upon the expertise available in the UN system and in DCs and provide a service for deciding technical disputes and to reconstitute facts pertinent to disputes in a co-operation project upon respective referral by the parties. The expert's decision could have legal force or be a mere recommendation;

- A Facility for Conciliation

  Often, a legally binding decision is not needed, but a procedure involving a neutral third party to induce parties to reach a mutually satisfying settlement. The respective facility could provide appropriate experts, organisational services and procedures for that purpose.

- A Facility for Summary Hearings

  Often, an expedient summary hearing and respective decision are necessary for co-operation projects, e.g. for filling of unforeseen gaps during project implementation or when performance bonds and bank guarnatees conditioned upon a respective facility for summary hearings could satisfy contractor interest for a neutral decision upon the calling of bonds, but still provide enough security for DCs.

The porposed mechanisms would have to be co-ordinated and be linked to programmes to develop Third World bargaining abilities and Industrial Development Law. For these reasons, a global, co-ordinating body appears warranted.

(iii)

A System for Resolution of Industrial Co-operation Conflicts

A global system for resolution of industrial co-operation conflicts would be responsible for co-ordinating technical assistance to be given to national and regional arbitration centres. In addition, it would, through co-ordination, information-sharing and recommendations, link the arbitration with the respective legal programmes on the global level. As an umbrella organisation, it would primarily not engage in actual arbitration, but support, if necessary, national and regional arbitration centres with advice, assistance, experts and information. In addition, it might be considered if a system for resolution of industrial co-operation conflicts should not be competent to decide upon appeal against awards by national and regional centres claiming material breach of substantive procedural rules. Such a limited appeal procedure might increase the co-ordination and the acceptability of national and regional arbitration centres.

A global system for resolution of industrial co-operation conflicts would co-operate closely with the proposed Commission for Industrial Development Law and be linked to the proposed programme to develop Third World bargaining ability. It would, as a whole, offer a variety of different conflict resolution services, while still leaving to individual host states the choice and thus not interfering with traditional reluctance against non-national arbitration. If necessary, a global system for resolution of industrial co-operation conflicts could also act as appointing authority. In that case, a system of rotating presidency between investment-exporting and investment-importing countries would provide for international conflict resolution in situations where current controversies over international arbitration have prevented a consensus from being reached through one of the already existing institutions.

CHAPTER 7: IMPROVING THE PERFORMANCE AND EFFICIENCY OF INDUSTRIAL ENTERPRISE CO-OPERATION

7.1 The Issue of Developmental Performance in Industrial Enterprise Co-operation

The impact of industrial co-operation on Third World industrialisation is determined by the developmental performance of co-operation projects. The concept of performance is understood in a wide sense, meaning a "positive contribution towards the achievement of the economic goals and established development objectives" of the host state, with the view of "maximizing the contribution to the development process". 1/

It is mainly the responsibility of the host state to ensure such a positive developmental contribution by foreign enterprises through appropriate development planning and putting such planning in operation with adequate rules and incentives. This applies particularly to foreign investment, where regulations imposing duties on the investor and incentives influencing his decision-making process aim at extracting a positive developmental contribution. 2/

If foreign business transactions are completely unpackaged, developmental performance of such technology transfer transactions is to a large extent determined by the regulatory system applicable. 3/

In the context of accelerated industrialisation relying partly on foreign inputs, a number of DCs have opted for the substitution of traditional foreign investment by non-equity arrangements involving the packaged purchase of industrial complexes of a high technological level. In that context, the issue of developmental performance acquires a new and unique meaning. As the self-interest of the foreign enterprises is not, as in foreign investment, centered on profit maximization from investment, but in maximizing profits from sales, the self-interest does not relate to the long-term performance of the industrial plant delivered in the context of the host state economy. Accordingly, mechanisms have to be designed and negotiated, which replace the incentive effect of direct investment by new performance guarantees and incentives which are geared to the specific situation of industrial plants in DC economies.

1/ Cf. Formulations of the Chairman of the Working Group on a Code of Conduct on TNCs, Doc. E/C.10/AC.2/8 of 13 December 1978, p.4.

2/ For an analysis of economic integration policies see: Wälde, Th., Law and Policy in International Business, 1979, 691ff;

3/ Cf. the negotiations for a Code of Conduct on Transfer of Technology, the draft versions of which provide for an extensive system of performance obligations, see UNCTAD Doc. TD/CODE TOT/1 of 13 July 1978, p. 18ff.

Insofar, the challenge is to develop a system of performance incentives which will be a characteristic feature of non-equity industrial co-operation. Traditional legal instruments governing the sale of equipment in commercial relations among ICs are not capable of fulfilling the function of stimulating the necessary self-interest of the foreign enterprise in the performance of the plant once delivered. First, even in ICs, the sale of complete industrial plants has not yet led to the development of appropriate legal instruments. 1/ Secondly, the very fact of underdevelopment requires a considerably more extended protection of DC purchaser of industrial installations. 2/

Legal instruments derived from traditional commercial transactions assume an equal distribution of knowledge and evaluative capacities between the contracting partners. In fact, the DC client is generally not able to select and evaluate the equipment and processes needed to establish an industrial complex. Also, a DC economy is more vulnerable to the consequences of malfunctioning of industrial plants. As there is no developed industrial infrastructure, the output of the industrial plant can not be easily replaced by other installations. Thirdly, not only the consequences, but also the risk of malperformance increases in the case of delivery of industrial complexes. This is due, inter alia, to the use of technology and equipment, which are suitable to IC's conditions, but inappropriate, or at least more prone to defects, in the case of an underdeveloped infrastructure, of insufficient personnel qualifications and of other unfavourable local conditions. Accordingly, new legal instruments to obtain the envisaged plant performance have to be developed. In that context, the notion of "performance" has to be developed to put into action the notion of "positive contribution to host state industrialisation". Due to the considerably greater repercussions of industrial malperformance on a highly sensitive process of programmed industrial development, such new legal instruments have to include a specific protection against the "developmental damages". Such instruments have to provide sufficient coercion and incentives for enterprises in respect to the required performance. The underlying philosophy of new methods is to compensate for the existing unequality and specific vulnerability of DCs in industrial co-operation. 3/

1/ With the exception of some rudimentary civil law codification in the GDR's new "Code on International Economic Contracts", in § 88-97 and the ECE's respective General Conditions, cf. particularly the Guide on Drawing up Contracts for large Industrial Works, No.E.73. II.E.13, of considerable interest is the attempt to elaborate a model contract for fertilizer plants in the contert of the UNIDO consultations on the fertilizer industry, cf. Report on the Second Consultation Meeting in 1978, ID/221.

2/ This case has been most forcefully stated by Algeria in its memorandum for the 1975 OPEC Conference, p.211, op.cit.

3/ Insofar, the study relies on the approach taken by most ICs' legal systems which have developed compensatory instruments to protect contracting partners in a position of de-facto unequality, e.g. protective legal rules concerning consumers, products liability, restriction on the use of standard clauses, landlord/tenant and labour relations. What is necessary could be termed a policy of "compensatory" or "affirmative" action in favour of DC partners in industrial co-operattion.

7.2 Extended Performance Guarantees in Turnkey Contracts: The Produit-en-Main Approach

In the most frequently used instrument for the package purchase of complete industrial complexes, the turnkey contract, the contractor is solely responsible for the delivery of an industrial complex, including design, procurement, engineering, construction and demonstration runs; often, such a contract includes also technical assistance relating to training, initial plant operation and marketing. The characteristic feature of the turnkey contract is the obligation of the contractor to ensure that the plant will function at the date of the final acceptance as promised. 1/

The turnkey contract has enabled DCs to obtain industrial plants of a high technology level in spite of scarcity of qualified personnel, engineering and design capacities. However, the experiences gained have led to a serious questioning of this contractual type. On the side of the foreign contractor, there is little incentive to care about post-start-up performance. He has a strong interest to reduce the quality of the plant under the lump-sum system; all that matters is satisfactory initial demonstration tests. In addition, there is little "learning-by-doing" experience for the local personnel charged with actual operations. DCs have accordingly had serious difficulties in successfully running plants once delivered. 2/ In response to such difficulties, some DCs, notably Algeria, have developed further the system of guarantees inherent in the turnkey contract in the direction of guarantees relating to the post-start-up production performance of the plant. 3/ Such guarantees, relating to quality and quantity of output for an extended period of time (3-12 months), to a maximum consumption of raw materials and energy, amount in fact to a guarantee for the training and the performance of local personnel, as the final demonstration tests are undertaken with local personnel in charge. 4/

The so-called "contrat produit-en-main" emphasizes less the productive unit, but the actual productivity of the plant. It is intended to be an instrument to effect the acquisition of national capacities to produce and hence emphasizes not only the operating plant, but the industrial development contribution. 5/ This concept of performance goes beyond the traditional notions of quality of sold equipment, but reflects a policy of extracting a positive developmental contribution from the foreign enterprise.

1/ Cf. Salem/Sanson, Les contrats clé-en-main et les contracts produit-en-main, 1979. Barcat/EUROECONOMICS, Exports of Industrial Complexes, 1978.

2/ Cf. Abdessalam, El Moudjahid of 25 March 1975.

3/ Cf. Algerian memorandum for the 1975 OPEC Conference, op.cit.

4/ Cf. Salem Sanson, op.cit.p.172ff.; Tuts, L'evolution des contrats clé-en-main, Droit et Pratique du Commerce International, 1977, p.633ff.

5/ This underlying "development telcology" is discussed in detail by Salem/Sanson, op.cit. and Benchikh, Les relations entre les entreprises transnationales et les pays sous-développés: contrats "produit-en-main" et arbitrage.

This concept has been put into practice to some extent in a few projects, basically in mechanical engineering and light industry. Even in these cases, contractors have insisted on a number of safeguards against the far-reaching guarantees in order to protect themselves from the risks associated with local personnel. 1/ For the foreign partner, the produit-en-manin approach creates considerable risks: The guaranteed success of training efforts with unexperienced local personnel may be difficult to control; the specific infrastructural deficiencies and a complex and slow-moving administration can become serious obstacles to the guaranteed plant performance. On the other hand, the produit-en-main approach justifies a higher remuneration for the contractor, to provide him with the necessary risk margins. In addition, successful performance may provide competitive advantages, open a market for newcomers and build up a positive reputation. From the contractor's side, much depends therefore on a careful assessment of the risk and of his performance capacities in the environment of the host state. 2/

From the host country's perspective, the apparently easy instrument to obtain an effective transfer of technology veils some disadvantages. 3/ The packaged-transfer character of the produit-en-main contract contradicts policies of self-reliant development through a depackaging of foreign inputs. Contractors, when combining their package for the industrial complex, will naturally favour established supply linkages and capital intensive technologies, as both strategies allow to reduce a risk factor which is difficult to control, i.e. supply and sub-contracting linkages with domestic enterprises and the training and performance capacities of local personnel. In addition, they will try to deviate as little as possible from established patterns so as not to incur risks of innovative adaptation; accordingly, design of plants and training of personnel will reflect the IC's mode of industrial operations to a great

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1/ For example, the contractors guarantees are conditioned on the respective counterfulfillment of the host state partner's obligations - e.g. the duty to provide a sufficiently qualified number of people for the training programmes instituted, the duty to provide authorizations in due time. Other contractual clauses excuse the contractor from responsibility if the local personnel proves uncapable to adjust to industrial operations. Force majeure also operates as a brake upon too far-reaching performance obligations.

2/ In the case of the FRG's publicly owned DIAG, produit-en-main contracts have led to losses well over 200 million DM, assumed by the government. The cause for such failure is disputed, but it seems plausible that DIAG overestimated its capacities in a completely new market and did not adjust its stipulated guarantees to its performance capacities.

3/ Judet, A propos du contrat clé-en-main, CRID/IREP-Grenoble, May 1977.

extent. This implies that the industrial complex will need constant inputs from the contractor to participate in the continuous process of improvement in the respective technology. Autonomous adaptation will be difficult, as the local personnel has not been subjected to the process of learning-by-doing characteristic for a self-reliant development of an industrial complex. Accordingly, to some extent the produit-en-main contract - as a modification of the turnkey-contract - perpetuates technological dependence. Furthermore, the risks associated with the produit-en-main contract eliminates all but the most capable and large TNCs. Middle-sized enterprises can hardly assume the considerable risks. Finally, the produit-en-main contracts requires a system of precisely defined guarantees and very detailed and comprehensive project planning. Alterations are difficult as they tend to disturb the whole package of carefully prepared and negotiated guarantees. The inflexibility inherent in the produit-en-main approach is therefore another shortcoming.

On the other hand, there are some distinct advantages, particularly for countries intent on a highly accelerated policy of industrial development. It seems that in situations where a package of equipment and technology of a predominantly captive character is needed, where the envisaged performance is at prerequisite for thereupon dependent industrial systems and where the effective transfer of "invisible technology" ("technological software") is required, the produit-en-main approach may be worthwhile and merits further improvement. This may apply, for example, in the case of plants, which are not of a repetitive character, but designed according to individual and specific features. Also, the produit-en-main approach is a funciton of the scarcity of competent technical and managerial personnel in spite of great need for the specific industrial performance at issue. 1/

Accordingly, in the next section, the study will explore possibilities to improve the produit-en-main approach, with the intention of (1) extending the scope and the effectiveness of performance guarantees, enabling foreign enterprises to assume such guarantees and emphasizing the important function of training; (2) creating a more flexible system of performance incentives to complement the often rather rigid system of guarantees; (3) creating procedural instruments for inter-party co-ordination to obtain optimal performance.

1/ Even there, care has to be taken that the "esprit de facilité" of buying guaranteed industrial performance without own efforts - particularly seductive for bureaucratic systems where initiative is not rewarded and where risks and responsibilities are shunned - does not seduce DCs to overlook the costs involved. The produit-en-main approach is certainly a func on of highly accelerated industrialization even at the cost of trading-off national self-reliance. The disadvantages discussed are hence often nothing more than necessary implication of policies of highly accelerated industrialization.

7.3 Guarantees, Incentives and Procedures to Create a Community of Interest in Developmental Performance

Optimal performance in industrial co-operation projects as discussed depends to a considerable degree on the capability of the contractual arrangements to create a self-interest of both partners in developmental performance and to co-ordinate effectively both partners' contributions to the joint project. The task is therefore to create mechanisms which take the place of the interest in profit maximisation as the efficiency incentive in direct investment. As two interdependent partners are involved, this task is highly complicated. In direct investment, the investor assumes directly risk and control; in the evolving quasi-investment types of industrial co-operation, both partners assume a share of the risk - the foreign enterprise through the risks associated with guarantees and other performance incentives, the host state enterprise through the risks associated with its own contractual obligation and the developmental repercussions of malperformance. Instruments which shape such risks and incentives will be explored in the following.

(i) Extending the Scope of Performance Guarantees

In addition to the guarantees of quality of equipment presently used in turnkey contracts and in line with the produit-en-main concept, new forms of guarantees should be designed covering all areas of plant performance which the contractor can be reasonably expected to control. Such guarantees would relate to the quality and quantity of the production, to consumption of energy and raw materials, but also to the competitiveness of the output, of repair and maintenance costs and, eventually, to the profitability of the plant. Such guarantees would run over an extended period of time and include plant performance with local personnel trained and technically assisted by the foreign enterprise. 1/

Of particular importance are the training obligations to enable local personnel to run the industrial complex successfully. Guarantees for the success of training are implicit in the other forms of guarantees discussed when these guarantees cover

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1/ The notion of a "contrat marché-en-main" and "bénéfice-en-main" has been theoretically developed to describe such guarantee systems; however - excepting buy-back and compensation arrangements discussed later - these concepts have not yet been put into practice. According to the character of the economy in question and of the needs to be supplied by the plant in question, such guarantees are often neither practical nor even desirable from a host state's view.

plant performance with local personnel. However, particularly in relation to contractor excuses for non-performance, it appears useful to provide also for specific guarantees in training in order to mobilize the contractor's training willingness and potential by associating him with the respective right. Such training obligations should comprise all functions of industrial personnel - not only operations, but also design, repair and maintenance, monitoring and improvement. The guarantees should go beyond short demonstration periods and tie the contractor to the personnel's performance over an extended period of time.

Extensive guarantees of the character discussed can only be reasonably demanded where the contractor is in corresponding control of the operations whose result he is to guarantee. Disputes frequently arising out of claims for non-performance and respective counter-claims relying on harmful client intervention could be reduced by separating the various areas where performance is guaranteed and by ensuring that the contractor is in reasonable control of respective operations. Another weakness of an extensive system of performance guarantees in comparison to traditional risk/benefit sharing through equity joint ventures is the relative rigidity: The contractor shares the risks without having a sufficiently adaptable planned and guaranteed performance system. 1/

Accordingly, there should be an in-build flexibility of the guarantee programme. The scope of guarantees and the amount of sanctions could be gradually decreased, parallel to the phase-out of control by the contractor. Such a system of gradual phase-out of guarantees would still tie the interests of the contractor to plant performance with national management and personnel, but increase his readiness to accept the guarantee scheme. In-built flexibility, however, needs other mechanisms which are more subtle than guarantees and which allow procedurally for continuous adaptation of the contract's objectives.

(ii) Performance Incentives

The guarantees discussed should set a fixed floor for contractual performance obligations; more flexible performance incentives should influence the contractor's

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1/ As has been reported in several discussions with turnkey contractors, the more extensive the guarantees, the earlier a rigid and comprehensive project programme has to be drawn up, a revision of which is difficult because of the sensitive balance achieved through complicated negotiations. On the other hand, it has also been reported that such a revision would often evidently be necessary, as the guaranteed out-put of a plant - planned and negotiated often ten years ahead of production - can easily become obsolete and no longer a useful input into a host state's industrial development.

self-interest in developmental performance. The issue is here of translating the concept of developmental performance into operational incentive criteria. 1/

Performance incentives to be developed further could be:

- Buy-Back Schemes for Remuneration of the Contractor.

  In such a scheme - widely used in East/West trade, but also to some extent in natural resources development ("production-sharing") - the contractor has a considerable self-interest in quality and quantity of production, as it constitutes all or part of his remuneration. Such a system associates him closely with risks and benefits of the project on a long-term basis and is a form of industrial co-operation close to joint investment ventures. 2/

- A System of Payment According to Plant Performance.

  Remuneration for the contractor would be dependent on the level of production reached over several years, taking into account quality and input factors. 3/ The system could be introduced gradually and co-exist with a lump sum or cost/plus system of remuneration, e.g. 80% to be paid in a cost/plus or lump sum payment, the rest in payment according to production. Here, another graduation could be introduced according to the responsibility fo the contractor, e.g. as "pilot", "co-pilot" and finally "technical assistant". (Systems of payment according to performance are frequent in the remuneration for workers and management, but such principles are also applied in sophisticated government procurement, e.g. the US ASPR, cited supra).

1/ For a discussion of related issues of taxation see: Penrose, Ownership and Control: Multinational Firms in Less Developed Countries, in Helleiner (ed.) A World Divided, 1976; several developed country governments have developed highly sophisticated methods acting as performance incentives in government procurement, e.g. value-engineering, target-costing, cf. the US General Accounting Office's Report to the US Congress, August 25, 1969, Opportunities for Increased Savings by Improving Management of Value Engineering; cf. also the US Armed Services Procurement Regulations, 32 CFR §§ 3-308, 1977.

2/ See: ECE, Analytical report on industrial co-operation among ECE countries, E.73.II.E.11, p.8.

3/ Cf. the Algerian proposed scheme in the cited OPEC memorandum of 1975, p.225.

- Remuneration According to Profits

Where profits can be used as a valid indicator of performance - and this is often not the case - a part of the contractor's remuneration could be in a share of the profits of the plant in the first years. This system would very closely approach a quasi-equity investment system through associating the contractor with the plant's profitability. Where profits are not a valid indicator for plant performance, quasi-profit criteria could be developed ("shadow profits"). The profit-centre concept employed within TNCs for performance measurement [1/] or performance measurement criteria employed in socialist states [2/] could be an indicator for performance incentives.

- Remuneration According to Sectoral Performance Criteria

In further developing the approach to devise non-profit indicators of performance, performance could be broken down into major elements, e.g. production, marketing, training, consumption. A part of the remuneration would depend on previously defined sectoral performance, e.g. by payment according to production, according to objectively tested training success, by marketing commissions.[3/] Technical assistance after a national take-over of management functions could be tied to post-operational goals and accordingly remunerated, e.g. to international competitiveness, increasing industrializing linkages through local content policies.

(iii)

Procedural Instruments for Inter-Party Co-ordination and Project Adaptation

Procedural instruments to allow parties to co-ordinate throughout the project's implementation their interdependent contribution and to adapt the project's programme of performances and guarantees should rely on the principle of co-management: Both parties should have a say over operations, the priority being granted to the party

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1/ Cf. Solomons, Divisional Performance: Measurement and Control, 1965.

2/ Cf. the report by I.D. Ivanov for the Joint Study which discusses, inter alia, the employment of shadow pricing methods for evaluating tenders.

3/ Cf. Penrose, op.cit.

most expert in a specific field; a gradual phase-out should be provided parallel to the ability of the client to assume the major management functions and parallel to the phase-out of contractor guarantees. The following organisational machinery should be considered:

- a top-level co-operation committee to meet periodically, review progress, attempt to settle disputes and empowered to adapt the contract, composed equally of representatives of both partners;

- an overall management committee with equal representation or host state majority, consisting of the chief local operations executives of both partners. It would have authority to make a binding adaptation in minor issues and to issue recommendations for major adaptations to the top-level co-operation committee;

- a committee for technical operations with contractor majority;

- a marketing committee with majority of the partner most interested and expert in marketing;

- a training and transfer of technology committee with host state majority; and

- a governmental relations committee responsible for administrative relations with host state partner majority.

Each committee would be empowered to propose modifications and amendments to the top-level committee. For minor disputes, the competent committee would be empowered to issue a decision with the right of each partner to appeal to the top-level co-operation committee - and with eventual recourse to arbitration. For major adaptation disputes, the proposed facilities for contract adaptation would provide a recourse. In addition, committee members could be entitled to call in an expert to decide on controversies requiring technical expertise. 1/

The roughly outlined system of co-management incorporates elements of corporate and contractural organisation in addition to an eventual recourse to third-party

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1/ Kopelmanas, Le regelement d'expertise technique de la CCI, Droit et Pratique du Commerce International, 1977, 417, 419: the proposed UN facilities for technical expertise could provide appropriate services.

intervention. [1] It would seem to provide a basic concept of quasi-corporate co-management for international industrial co-operation. [2]

7.4 Protection against Malperformance: An Operational Concept of "Development Damages"

The acute vulnerability of the developing economies requires specific protection against malperformance of industrial plants. [3] Insofar as direct damages are concerned, traditional instruments of commercial law are sufficient to provide adequate protection through obligations of replacement and correction of faulty equipment. [4] However, faulty performance - due to faulty design, construction, inappropriate process, insufficient training - can produce repercussions beyond the direct damages affecting an industrial plant. Developing countries are particularly sensitive to such "consequential losses", because the receiving economy is in a stage of accelerated industrial development. Normally, there are insufficient or no alternative sources for the plant output which is deficient due to malperformance; in addition, in integrated industrial systems of an economy where the interdependence is carefully programmed, the deficiency of one important element often implies the malfunctioning of the complete industrial production chain. [5] We can hence use the notion of "development damages" to convey the specific problem caused by consequential losses to a developing economic system. Turnkey contracts generally exclude any liability for consequential losses. This leaves the receiving economy with an increased vulnerability to developmental damages, particularly as insurance is difficult to arrange. [6]

1/ It is suggested that the considerable experience with intra-corporate co-determination of labour, linked to judicial or quasi-judicial mechanisms to break dead-lock situations in several ICs, e.g. the FRG's legal system of co-determination, offers interesting methods of co-management and of internal conflict resolution.

2/ Also the analysis by Touscoz, Gestion de la cooperation, contribution to the June 1979 Nice colloquium on International Industrial Co-operation Contracts.

3/ Cf. the proposals formulated by Algeria in its 1975 OPEC memorandum, op.cit.p226.

4/ The discussion on the draft model contract for fertilizer plants held 1978, report cit.

5/ Algerian memorandum, 1975, op.cit.

6/ For the emphasis laid by DCs on protection against consequential losses arising from industrial co-operation see the draft resolution concerning the establishment of an insurance system for guaranteeing contracts concluded by DCs with enterprises from developed countries submitted by the Group of 77 and Romania at the Lima Conference, Doc. ID/Conf.3/L.9 of 22 March 1975; on the difficulties of obtaining insurance cover from commercial sources and on the discussion on the proposal of a multilateral insurance in the case of the fertilizer industry see a report prepared by Hogg Robinson and Gardner Mountain Reinsurance, Doc. ID/WG. 284/1 of 16 October 1978.

The following proposals, therefore, attempt to find a solution for DCs' need for coverage against developmental damages; In doing so, they have to take into account the need to determine (1) what developmental damages are; (2) under which conditions the foreign enterprise should be liable for them and to what extent; (3) what supporting mechanisms are necessary to make contractor responsibility for some form of developmental damages a viable proposal.[1/]

Before presenting the outlines of such mechanisms, it is necessary to invoke basic principles and modern concepts of the law of damages: [2/]

- Liabilities should be imposed on the actor who can best control the risk and minimize the likelihood and the scope of losses;

- Liabilities for large-scale losses should be limited, otherwise risk-producing industrial co-operation is prohibited by the risk of unlimited liability. Eventually liable actors have to be able to calculate and to find insurance for the assumed risks;

- If the interaction of two parties causes losses, both should be tied to a community of interest to reduce the likelihood and the scope of the risk;

- Risk and benefit from an industrial activity should be commensurate.

From these principles we can draw a first and important conclusion that unlimited liability for developmental damages is not feasible. The contractor may have control over malperformance, but no control over the developmental repercussions of his activity; in addition, unlimited liability would be prohibitive and could not be insured. It would also give rise to complex disputes over the financial value of the relatively vague and ill-defined concept of "developmental damages".

The solution suggested here can only concern a mechanism of limited liability. The solution has to center on the areas the respective partners control. The contractor has considerable control over the planning and execution of the project; the host state has more control over the developmental repercussions of deficient performance.

1/ Cf the discussions of the IDB (11th session, Vienna, 23 May-6 June 1977, Doc. ID/B/SR 225, p. 5,6) where the issue was raised if such protection could not be "obtained by existing legal processes at the national level". The presently introduced proposal attempts to combine legal methods on the national support system to make such contractual instruments and procedures economically viable.

2/ See Calabresi, The Costs of Accidents, 1970.

It must, therefore, be the task of the host state to indicate - in the initial contract negotiations - the potential for the scope and the financial value of the developmental risk associated with malperformance. The host state would attach quasi a price label to the developmental risks of a project. This "developmental value label" would express the DC's assessment of developmental risk over which it has morecontrol than the contractor: the dependence of interdependent industrial development on the project at issue, quantified in monetary terms. The criteria for expressing the developmental value of the project would be entirely the host state's responsibility. It could use shadow-pricing, rules of thumb or the overall contract price as a basis and multiply it with the developmental value attached to a specific project. It could, in free bidding and negotiations, determine the limits of acceptance among contractors and the additional price margins demanded for compensation.

In case of non-performance, the contractor would be obliged to take corrective action up to the agreed developmental value or reimburse the host state. It could also be arranged to contract another enterprise to perform the original contractor's task, with the developmental damages due to be used for compensation. The developmental value approach could employ a ceiling and provide criteria assessing the developmental losses. It could also, in a more simplified form closer to the non-performance penalty method, stipulate that developmental damages of specified amounts are due when certain project targets have not been reached. The outlined limited-liability approach allows insurance. Particularly, it would force the contractor to assess his performance capabilities and to make every effort at contractual performance. This preventive effect would be reinforced by the great interest by insurers and banks to assess the performance capabilities of the contractor in respect to contractual performance and developmental damages risk. 1/

It is evident that such a system of contractually stipulated limited contractor liability for developmental damages would have to be carefully elaborated through the proposed UN programme to support Third World bargaining abilities. In addition, contractors - particularly those from middle-sized enterprises in developing countries - would need a safety net provided by international action to enable them to assume the considerable risks created by even a limited responsibility for developmental losses. This safety net would be created on the level of inter-governmental agreements and through the proposed Contractual Liability Insurance Consortium (CLIC) discussed below.

1/ Nelson, "A Banker's view of the risks in Middle East construction", speech given at the Middle East Construction Conference, October 31, 1977 in Dubai.

7.5 Enforcing Performance Obligations: Performance Security Through Bonds and Guarantees

Contractual obligations are often, per se, not sufficient to force the contractor into effective performance. A system of sanctions is often necessary which allows effective enforcement of obligations and which motivates parties to perform in order to avoid the risk of enforcement. In international industrial enterprise co-operation, the enforcement system is not particularly strong. 1/ Judicial and arbitration proceedings are time consuming, the outcome is often difficult to predict and often they are used to protract performance instead of accelerating it. They can rarely provide for immediate correction and compensating liquidity, often the heart of the parties' interest. Accordingly, a system of liquidiated damage and penalty clauses, bolstered by bonds and bank guarantees, has developed in international commercial relations. It is primalrily geared to provide some measure of coercive action, but also instant security against malperformance. 2/

At present, contractors in the US are, for example, required to post performance bonds in which a bonding company guarantees performance of stipulated construction work up to 100 per cent. Bid bonds (1-2% of contract price) are required to guarantee the seriousness of bidding; advance payment bonds guarantee the repayment ability in case of cash advances by the client (up to 20%); bank guarantees and performance bonds (up to 15-20%) are requested as a security for non-performance. 3/

While contractors - and the international and national industry organizations 4/ - recommend that payment on such bonds and guarantees be conditioned upon approval by the contractor or proper documentation - such as a respective arbitral or judicial award - many DCs, particularly in the Middle East successfully insist on unconditional guarantees which have to be paid by the guaranteeing bank or surety company on first demand to the client. 5/

1/ For the need for and use of liquidated damages and penalty clauses in international commercial transactions, see UNCITRAL Doc. A/CN.9/161 of 25 April 1979.

2/ Dubisson, "Le droit de saisir les cautions de soumission et les garanties de bonne exécution", Droit et Pratique du Commerce International, 1977,p 423; Eisemann, "Arbitrage et garanties contractuelles", Revue de l'Arbitrage, 1972, p.379.

3/ Cf a report by Business International, 1978, on bonding practices in Saudi Arabia, p. 67ff.; for the use of performance security in public procurement cf. UNITAR, International Procurement (by Westring), 1974, p.32ff.

4/ For example the ICC, cf. the new ICC uniform rules for contract guarantees, Publ. No. 325, 1978.

5/ See Harbottle v. National Westminister Bank, Law Report, February 7, 1977; also Owen Engineering from Barclay's Bank, Law Report July 29, 1977.

Bonds and unconditional bank guarantees are a defensive instrument for the DC client. They replace, particularly in the case of newcomer contractors, trust and the availability of judical sanctioning. They are, at present, mostly geared towards civil works obligations. They are not yet oriented towards performance obligations under the produit-en-main approach nor to the proposed method of compensation for developmental damages. A development of the bond system is warranted for several reasons: At first, it improves the likelihood of effective performance through the leverage effected by such bonds; secondly, medium-sized enterprises could compensate their weakness as compared to large TNCs in respect to size, reputation and ability to shoulder risks if an appropriate mechanism could be found which protects DCs by sufficient performance security, while still allowing such firms to obtain corresponding insurance coverage. 1/ Thirdly, the further development of the bonding system increases the likelihood of effective performance through bank and surety company securing of contractor performance capabilities. It is, therefore, suggested to develop, through appropriate model clause instruments, the following security instruments:

- performance securities related to performance obligations covering post-start-up operations (produit-en-main guarantees);

- performance securities for contractor liability for developmental damages.

Such bonds should cover a higher amount than is practiced today (e.g. 50% of contract price or 25% of developmental damages ceiling). However, as such a relatively high security would act as a deterrent if unconditional and payable on-demand without proper documentation such securities should be conditioned upon an arbitral award to be reached through summary proceedings. 2/

The proposed facilities for summary proceedings within the SRIC system of national or regional arbitration would be a forum to decide on claims for immediate payment of performance securities. In addition, the UN system should draw up model terms for the traditional performance securities (bid, repayment bonds) to countervail the model terms elaborated by industry associations in favour of the contractor (e.g. the already cited model terms elaborated in 1978 by the ICC or, in the FRG, the VDMA's model provisions).

1/ Cf. for the issue of insurance for on-demand bonds a paper by Investment Insurance International (III) (Radcliffe) on Political Risk Insurance (no date).

2/ Also the proposal by Dubuisson, DPCI 1977, 445 which is in a middle position between automatic payment obligation, on one hand, and a full arbitral proceedings on the factual issues on the other hand.

The model terms to be elaborated would also provide for guarantees of the parent corporation for malperformance liabilities of subsidiaries. Thus, the risk encountered by DCs in special project companies with limited liability and bonds only partially covering claims [1] could be reduced.

7.6 An International Supportive Framework for Performance Obligations in Industrial Co-operation Contracts

The proposals to improve the developmental performance in the context of the transfer of industrial complexes increase the risks and the finacial burden of contractors to a considerable degree. It seems that only very large and experienced companies would be able to assume these risks. In order to increase the potential for co-operation with medium-sized industry, particularly from DCs, supportive measures are necessary on the international level. These measures would concentrate on insuring the risks of performance and consequential loss responsibilities or issuing direct guarantees through governmental or international agencies.

(i) Risk Assumption and Joint Project Evaluation Through Inter-governmental Agreements

One method to provide the necessary supportive framework to assume risks which are too large for enterprises - particularly of medium scale - would be through inter-governmental co-operation. [2] Jointly, through mixed commissions and working groups, the governments could undertake an evaluation of projects and the respective enterprises. Such joint evaluation process would reduce risks of non-performance. In addition, the home state of the supplier of industrial complexes might be induced to provide a performance guarantee. This would amount to subsidization of contractors and is not far from present practices, such as investment insurance, export credit, export credit insurance and government sponsored equity participation (e.g. by the FRG's DEG). The major quid-pro-quo to be offered to ICs in exchange would be corresponding commitments by the host state for contract stability. [3] The mixed commission would also decide on the "developmental value criteria" determining the scope of developmental damages in case of malperformance. ICs might also be persuaded to integrate such a policy of risk assumption into their programmes geared to promoting international co-operation by their own middle-sized enterprises; their chances would be greatly increased by governmental assumption of performance risks.

1/ Cf. the Algerian OPEC memorandum op.cit., p. 220.

2/ For a discussion of the potential inherent in intergovernmental co-operation see supra. Cf. a note by Ph. Kain/CREDIMI (1977) on government guarantees prepared for the Joint Study.

3/ This package concept will be explained in detail subsequently.

(ii) A Contractual Liability Insurance Consortium

To back up guarantees given by contractors - particularly those relating to the produit-en-main performance obligations and to developmental losses liabilities - a Contractual Liability Insurance Consortium(CLIC) is proposed. 1/ This mechanism primarily would assume risks which hinder non-TNC enterprises in competing effectively for large scale industrial co-operation projects. It would compensate for their inability to assume the risks of performance obligations and performance securities. CLIC would support contractors' capacities to overcome adverse financial situations when events prevent them from successfully completing their contractual tasks. Also, DCs' contracting authorities would be secured against project failure caused by the contractors' inability to cover losses caused by unforeseen events. Therefore, it would very much be directed at promoting industrial enterprise co-operation with non-TNC enterprises which have hitherto often been reluctant to undertake large-scale projects in DCs. To guarantee the completion of projects, contractors had to buy insurance against narrowly defined risks from commercial insurance companies or supply bank guarantees or bonds as a proof of their capacity to fulfill their contractual obligations. Risks coverage was available, however, only in cases where commercial insurance firms had determined that the risks could be effectively and profitably insured. Banks granted guarantees only to customers with assets large enough to serve as security if the guarantee were called. With growing project size, the necessity to cover risks hitherto not held insurable, and taking into account the proposed liability for developmental damages, insurance or guarantees will be ever harder to arrange.

Three basic problems have to be overcome to create financial conditions conducive to an extended and better risk coverage:

- foreign contractors will be unable to put up more money to build up reserves for contingent liabilities or only at significantly higher costs to the DC;

- DC contractors would be effectively eliminated from the market of industrial construction works as they lack the standing with banks necessary for guarantees;

- looking at particular risks or at the asset base of a contractor will not take into account the project's significance for the host state, nor the contribution the host state can make to help contractors to complete projects.

To remedy these problems, CLIC is planned to function as a broker in capacities matching DCs' interests, financial institutions and IC interests in supporting industrial complexes. Its aims are threefold:

1/ For an extended analysis and elaboration see the report by A. Stockmayer for this study, Vienna August 1979.

- it will have to identify and assess risks of projects. After an exhaustive assessment, there will be a determination of what risks may be covered by commercial insurance, what risks may be reduced by control and what risks have to remain with the contracting parties;
- it will have to syndicate the risk cover.acting as an agent for participating financial institutions;
- it will have to influence insurance and guarantee conditions in a way to harmonize terms and thereby create more transparency and security for contractors as well as contracting authorities.

CLIC will, therefore, enable contractors to undertake high-risk projects, i.e. projects with possibly costly performance requirements. At the same time, developing countries can expect from CLIC support for projects to be initiated and pursued with due regard to the importance of the project's contribution to host state industrialization.

CHAPTER 8: HOME AND HOST STATE CO-RESPONSIBILITY: PACKAGING PERFORMANCE AND STABILITY COMMITMENTS

Stability of the legal regime of industrial co-operation is very much a concern of northern investors. On the other hand, the question of adequate and development-oriented performance of delivered industrial complexes and of traditional foreign investment is a matter of intensive interest for developing countries. The principle of interdependence hence points in the direction of combining mechanisms catering to those two essential concerns into a quid-pro-quo package. It is not that ICs do not have sufficient investment insurance schemes at present. It is possible to insure new investment, loans, profit-sharing and service contracts against political risk (OPIC, Hermes, ECGD). However, a multilateral risk insurance facility, sponsored by international organizations, such as UNIDO, might help create an awareness that investment stability is a matter of concern to southern as well as to northern countries. The same considerations apply to performance requirements. Performance guarantees have been assumed by socialist economies when the state accepted direct liability through an intergovernmental co-operation agreement. But market economy governments have also at times assumed de jure or de facto, partial or complete responsibility for mal-performance of contracts implementing an intergovernmental framework agreement. This has been particularly true of intergovernmental agreements which relate to the purchase of high technology armaments. But it has also been the case when industrialized countries have prompted their own state enterprises to enter into high-risk and innovative contractual arrangements (produit-en-main contracts), when the risks finally required a state subsidy to avoid bankruptcy of state enterprise. 1/

All the mechanisms proposed in the sections on stability and on performance requirements reflect this quid-pro-quo approach. Here, an institutionalization of the quid-pro-quo approach through intergovernmental instruments is suggested.

Investment insurance as discussed above and contract insurance through CLIC constitute quid-pro-quo packages in themselves. Both help to stabilize investment and contract conditions in exchange for better performance. But together they also reflect the quid-pro-quo approach. While the regional investment insurance systems in connection with ICs' and DCs' insurance schemes are primarily geared toward accommodating ICs' concerns over investment conditions, CLIC provides an instrument to allow for extended contract stability through the build-up of outside reserves in the form of guarantees and insurance. Reversely, regional investment insurance systems may be an instrument to reconcile conflicting interests in order to extend investment insurance, while CLIC can create conditions for broader performance guarantees.

1/ The DIAG-Case between the FRG and Algeria.

The package concept can even better be demonstrated by establishing both types of insurance through one joint multilateral intergovernmental agreement. The proposed concept of a global UNIDO system of investment stability could serve as the basis for such establishment.

Being closely related in principle, investment insurance and CLIC would also be complementary as to their operations. Basically, investment insurance will cover the value of investment. CLIC channels insurance to projects to secure the orderly completion of projects as planned.

CHAPTER 9: HOST STATE CONTROL OVER INTERNATIONAL INDUSTRIAL ENTERPRISE CO-OPERATION

Control is an essential factor for developing countries wishing to obtain an optimal contribution to their industrial development from industrial co-operation with foreign enterprises. National control has to countervail the orientation of TNCs towards global, and not national, profit interests and it has to reduce the impact of the non-national decision-making process by TNCs on the host state economy. 1/

The legal foundation of host state control is the legislative sovereignty; the bargaining leverage enabling developing countries to impose control lies in the host state's ability to prohibit and regulate the access to its economy. The need for control of TNCs and foreign investment has been expressly endorsed by the authoritative UN resolutions concerning a NIEO 2/ and by the Lima Declaration (Art. 42). The objective of control is "to ensure that these activities are compatible with the development plans and policies of the host countries". 3/ Effective control, however, is severly hampered by several obstacles:

- insufficient national administrative and managerial capacities to establish a countervailing system of control;
- insufficient willingness to face the considerable challenges of controlling foreign enterprises;
- insufficient abilities to obtain, analyze and use effectively the information necessary for strategic policy-making;
- superiority of TNCs over the host state in terms of resources for the use of information and managerial, financing, technological and marketing resources, i.e. the superior TNC bargaining power;

1/ Cf. on the issue of control of TNCs, Vaitsos, Power, Knowledge and Development Policy; Relations between TNCs and Developing Countries, in Helleiner (ed.), A World Divided, 1976, p. 113; Penrose, Ownership and Control: Multinational Firms in Less Developed Countries, IBIDEM, p. 147; Sauvant, Controlling Transnational Enterprises, in, Sauvant/Hasenpflug, The New International Economic Order, 1977, p. 356; for a survey of entry terms and regulations see, The UN Survey, National Legislation and Regulations relating to TNCs, E.78.II.A.3, and Robinson, National Control of Foreign Business Entry, 1976;

2/ See GA Resolutions 3201, 3202, S-VI; 3281, XXIX;

3/ Cf. also the, Formulations by the Chairman, for the draft Code of Conduct on TNCs (Doc. E/C.10/AC.2/8) of 13 December 1978, at p. 4: TNCs should take effective measures to ensure that their activities are compatible with, and make a positive contribution towards, the achievement of the economic goals and established development objectives of the countries in which they operate. See also p. 6 for policy formulation relating to ownership and control.

- superiority of TNCs over the host state in terms of resources for the use of information and managerial, financing, technological - and marketing resources, i.e. the superior TNC bargaining power;
- the global orientation of a TNC and its operations reduce to a substantial extent the impact of developing countries' - but also developed countries - policies, which can only exercise pressure on the local subsidiary of the global and integrated corporate system, but not on the central TNC decision process.

The chief factor for success of control policies seems to lie in self-reliant national efforts mobilizing the bargaining power and the resources available to the host state. Co-operation on the regional and international level is the next step in countervailing the global system of TNCs. The present chapter will explore the various dimensions of host state control policies, integrate the respective efforts undertaken elsewhere in the UN system and attempt to add additional aspects and proposals.

Before embarking on an analysis of the distinct dimension of control, the concept of control itself needs some clarifications. 1/ Control, i.e. influence on the outcome of the decision-making in investment and enterprise co-operation, can be achieved basically in two ways:

(i) through procedural, internal control, i.e. influencing the structures, elements and participants of the decision-making process of the operating company and the foreign enterprise. Control of that form is exercized through state participation in the operating company's equity, representation on the company's board, distribution of control through management agreements. However, also regular reporting on, or monitoring of, performance by state agencies can introduce elements of procedural control.

(ii) Through external control, i.e. through outcome-oriented obligations placed on the co-operating foreign enterprise as conditions for the authorization of entry and operations.

Finally, whatever the legal instruments available, the real scope of host state control depends very much on explicit and implicit processes of bargaining in all phases of co-operation. Control, be it through the legal forms available, or simply by mere "persuasion" in bargaining, depends at all times on the relative bargaining strength of both sides and on their ability and willingness to use that strength. 2/

1/ Cf. the contributions by Penrose, Singh, R.K.D.N, and Wälde, Th., on instruments to control TNC activities for the UNCTC Roundtable on Negotiations with TNCs, April 1978 (forthcoming);

2/ Cf. Kirchner et. al., Mining Ventures in Developing Countries, vol.I, 1979, p.137ff.

9.1 Ownership Policies and Control through Enterprise Organization.

The major instrument used by developing countries to obtain control has been through policies directed at ownership. Legislatively engineered nationalization has been the most visible and controversial form. 1/ Disinvestment - gradually leading to nationalization, according to respective legislation or investment agreements - and equity joint ventures types have been less controversial ways to achieve partial or complete national ownership of traditional foreign investment. 2/ The result of such policies, however, have often been formal devices which disguise, under the veil of legal forms symbolizing host state control, the perpetuation of effective foreign control. This is particularly so, where the absence of sufficient managerial, technological, financing and marketing capabilities forces host states into dependence, whether or not transmitted through foreign ownership. 3/

In modern industry, a dissociation has largely taken place between ownership, i.e. equity stock, and control of large corporations. 4/ Control consists less in legal entitlement to corporate ownership, but in entitlement to control over functions of decision-making which are crucial for industrial activity. Such functional control may or may not co-incide with ownership; therefore, more attention must be directed at the organization of corporately or co-operatively structured decision-processes than at ownership. Effective state control irrespective of ownership can be obtained by assuming and effectively exercising the respective functions in the decision-process of the co-operation project. A complete discussion of the issues involved cannot be undertaken here. 5/ However, the concentration on ownership should be expanded to comprise strategies of effective host state functional control through appropriate organization of co-operation projects. 6/

9.2 External Control through Exercise of Regulatory Powers.

Regulations are an instrument to exercise external control over co-operation with foreign enterprises. They aim at specific functions of business activities, without affecting directly ownership. There is sufficient information on investment regulations

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1/ Cf. UN, TNCs in World Development: A Re-Examination, op.cit, at p. 233, for a survey of national take-over;

2/ Cf. UN, op.cit. at p. 149ff;

3/ Cf. Weinstein, Multinational Corporations and the Third World, International Organization, 1976, 373; Penrose, Ownership and Control, 1976, op.cit.; Vaitsos, Power, Knowledge and Development Policy, op.cit. at p. 131, emphasizes that nationalization can prompt a mobilization of will to master the necessary functions otherwise controlled by foreign enterprises; Morris/Lavipour/Sauvant, in Sauvant/Lavipour, Controlling Multinational Enterprises, 1976, p. 111 ff confirm in a case study this possibility;

4/ Cf. Berle + Means, The Modern Corporation and Private Property, 1934; see also Hurst, The Legitimacy of the Business Corporation, 1970;

5/ See the elaboration of a concept of "co-management" supra; see also the cited contributions to the 1978 Roundtable on Negotiations with TNCs by the UNCTC;

6/ See also Touscoz, 1979, op. cit.

used in developing countries. 1/ The yet unresolved problem of the regulatory control approach lies in the effective implementation and the continuous monitoring of the respective projects' performance. Some proposals of the Joint Study (e.g. the proposed technical assistance for "national foreign investment centres") aim at increasing the efficiency of host state administration. However, in respect to implementing and monitoring performance, little information on the optimal techniques and conditions is available. It often seems that once regulations have been formulated, interest in the respective problem disappears; hence, regulations often either have no effect or produce an often inefficient bureaucratic machinery. It is therefore in the area of implementation and performance evaluation of industrial co-operation, that a new effort to assist developing countries has to be undertaken. 2/

9.3 Countervailing the Global Orientation of TNCs through National Action.

An often unsurmountable barrier against developing countries' attempts to obtain full control lies in the inherent constraints of national control policies. They are directed to the national subsidiary of a globally operating TNC, but crucial decisions are taken at corporate headquarters abroad. There are several strategies through which developing countries can hope to have some effect on the global decision-making affecting their economies:

- Developing countries can promote the operational autonomy of foreign subsidiaries to a maximum extent practical ("corporate decentralization"). The following requirements can be used to push for corporate decentralization and hence an increased sensitivity to host state economic policies: national board membership, extensive obligations to account for intra-enterprise transactions and directives, liability of the parent company for losses incurred and business opportunities missed by the subsidiary through corporate centralization, protection of national shareholders, re-investment policies. International organizations could assist such policies by drawing up a model corporate statute to secure some measures of operational autonomy for subsidiaries.

- Developing countries can support private and public enterprises to provide a countervailing power and a vehicle for the absorption of skills and capacities from TNCs. 3/

1/ Cf. UNCTC survey on Investment Legislation, op.cit.;

2/ See UN, TNCs in World Development: A Re-Examination, op.cit., at p. 140 ff;

3/ Cf. the Lima Plan of Action's emphasis on state enterprises, calling developing countries to "ensure an adequate role for the state in the direction of industrial development and the public sector in the expansion of industries" - para 58(n). See for the role of state enterprises in partnership with TNCs Evans, Multinationals, State Owned Corporations and the Transformation of Imperialism, 1976; Aravjo/Dick, Governo, Empresas Multinacionais e Empresas Nacionais, Pesquissa e Planejamento Economico, vol.4, 1974, p. 629 ff.

- Finally, developing countries can extend their national policies to the parent corporation. The US have in several areas followed an often controversial policy of extending the reach of their economic regulations to foreign subsidiaries of US TNCs. 1/ Inversely, developing countries could hold parent corporations responsible for subsidiaries' actions affecting developing countries' economies. 2/ Also, developing countries could require parent corporations to assume full responsibility for their local subsidiaries. 3/

9.4 Countervailing the Global Orientation of TNCs through International Action.

The prevailing regulatory approach for controlling the impact of TNCs on host state economies soon encounters an essential limitation: Operating globally, TNCs have a relatively low sensitivity to the interests and policies of individual host states while host states' exercise of national economic sovereignty can rarely extend a substantial impact on the TNCs' central decision process. Accordingly, national action has to be supplemented by international action. 4/

On one hand, international action expresses national sovereignty at a level of collective action, which corresponds to the global level of TNC operations; on the other hand, it is the area where attempts can be made to find a global consensus on an international regulatory approach. The present negotiations for Codes of Conduct on TNCs and on Technology 5/ are attempts to achieve a global consensus on international and national control of industrial enterprise co-operation and its actors. The weakness of these Codes can already be inferred from the present preparatory documents. 6/ The necessity to harmonize substantial divergences will probably lead to relative unprecise exhortation and guidelines. 7/ A standstill can be avoided by perceiving the Codes of Conduct as steps leading to international action to control TNCs. Such action will be outlined in the following.

1/ Cf. US v. ALCOA, 148 F2d 416 (2d Circ. 1945); Craig, Application of the Trading with the Enemy Act to Foreign Corporations, 83 Harv. LRev. 579 (1970); Grossfeld, Praxis des internationalen Privat- und Wirtschaftsrechtes, 1975, 103 ff;

2/ See for the problem of host state jurisdiction the contribution of Fatouros to the 1979 Bielefeld symposium on Codes of Conduct on Multinational Enterprises, op. cit.;

3/ Cf. Blanpain, The Badger Case and the OECD guidelines for multinational enterprises, 1977;

4/ Cf. Sauvant/Lanier, Host-Country Councils: Concepts and Legal Aspects, Contribution to the cited Bielefeld symposium in 1979, p. 9 ff;

5/ For an extensive discussion of these Codes and related instruments see the cited Bielefeld symposium;

6/ Cf. UN Doc. E/C.10/AC.2 of 13 December 1978; UNCTAD Doc. TOT/1 of 13 July 1978;

7/ See Fatouros, op.cit. supra.

(i) Action to give effect to Codes of Conduct.

Apart from the probably consultative international implementation machinery attached to Codes of Conduct, the decisive level of action to give effect to these instruments is national and international follow-up. It is the task of host states to adapt their legislation to the Codes and, if practical and useful, to take the Codes as a starting point for further development. Regionally, developing countries should encounter fewer obstacles in reaching a consensus and can develop respective Regional Codes with a higher degree of preciseness and implementation. Even if the Codes would not be legally binding, the substantive content of the Codes could produce some effect. 1/ It is, therefore, the task to make the Codes most effective, partly by recognizing how they differ from traditional international law, partly by recognizing Codes as an element of international public policy and as a legitimizing force for host state action. In this way, the Codes are one element in the process of creating a New International Industrial Development Law. Also, developing countries could attempt to negotiate through bilateral intergovernmental agreements for an inclusion or further development of the Codes' principles in order to control TNCs. 2/

(ii) Improving and Complementing Codes of Conduct.

Improvement could be directed at specific matters or undertaken by specific groups of countries, where it would be easier to reach a consensus on sufficiently detailed rules. Examples could be Codes of Conduct on taxation, regional investment, financing, disclosure, investment and co-operation incentives.

(iii) Representing Global Interests in TNCs' Decision-making.

The decisions taken at corporate headquarters of TNCs often affect interests (host states, home states, employees) which have no representation and no access to the centralized decision process. A number of TNCs have, to respond to the problems raised, established consultative committees composed of directors of foreign subsidiaries or important business partners around the world; some trade unions have set up "world councils" where trade union representatives meet, exchange information and experience with respect to particular TNCs and sometimes have been able to discuss these issues with the respective TNC. 3/ It appears that a further development

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1/ Cf. Baade, Contribution to the cited Bielefeld symposium.

2/ The proposal of negotiating inter-governmentally for uniform conditions of industrial co-operation to be applied to or incorporated into co-operation contracts on the project level, supra, or of negotiating for fiscal co-operation between governments, infra, fits into this method of expanding inter-governmental industrial co-operation;

3/ Cf. Pursey, The Trade Union's View on the Implementation of Codes of Conduct, contribution to the cited 1979 Bielefeld symposium.

of such consultative mechanisms would reduce frictions created by unexpected decisions severely affecting interests, particularly in removed developing countries. It would also give an opportunity to discuss strategic issues and to obtain relevant information among the various groups affected by TNCs and its central management. The development of world consultative committees attached to specific enterprises could take several forms: Each major TNC could establish voluntarily a consultative world committee, composed either of the representatives of host and home states ("the public interest") or of trade unions represented to a substantial degree in the TNC, or both groups could be included. 1/

TNCs might have an interest in establishing such committees, whether for the good-will or for the persuasive effect of international recommendations. If sufficient positive experiences had been collected, further action could be then considered to strengthen such mechanisms. The proposed mechanism would fit into the corporate organizational structure of enterprises and even be in line with the development towards greater, legally articulated social responsibility of global corporations. 2/

9.5 Control of Transfer Pricing.

The problem of transfer pricing - or better of affiliated transactions - constitutes a serious challenge for host state policies which has been amply discussed in several studies. 3/ A substantial and increasing part of world trade is effected through intra-enterprise channels. As criteria for at-arm's-length prices are absent, prices are often set according to specific company strategies by corporate headquarters. Even if it has been difficult to adduce substantive empirical evidence on the actual scope of abusive transfer pricing due to the confidential nature of such transactions 4/, it is quite clear that this problem warrants serious discussion and action. In this context, the experience of several ICs in introducing strict fiscal controls on transfer pricing 5/ has demonstrated the tangible benefits to be achieved by such action through tax authorities. 6/ It seems unlikely that any method of control is

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1/ Cf. for host state councils Sauvant/Lanier, cited contribution to the Bielefeld symposium 1979; for employees' "global information and consultation body" see the International Confederation of Free Trade Unions' (ICFTU) proposal reported by Pursey, op.cit.; Sweden has proposed a similar system in the intergovernmental working group for a Code of Conduct on TNCs at its Seventh Session, March 1979;

2/ See Sauvant/Lanier, op.cit., supra, at p. 40ff; it is evident that members on such committees would be subject to fiduciary duties to the extent they receive non-public information;

3/ Cf. UN, TNCs in World Development: A Re-examination, p. 128;

4/ See the studies undertaken by UNCTAD, Dominant Positions of Market Power of TNCs: Use of the Transfer Pricing Mechanisms, Doc. TD/B/C.2/167 of 30 November 1977, at p. 36 ff;

5/ Cf. Section 482 of the US Internal Revenue Act; para 1 of the FRG's Aussensteuergesetz;

6/ Cf. UNCTAD, op. cit. at p. 5.

able to eliminate completely the well-known disadvantages countries suffer through abusive transfer pricing. However, the scope of disadvantages can be reduced to a considerable extent, as the experience of several developed and developing countries has shown. 1/ As the work on transfer pricing has received ample attention, particularly by the work of the UN Group of Experts on Tax Treaties, 2/ the present study will only highlight some essential issues.

Methods to correct abusive transfer pricing can be taken:

(i) On the national level through regulatory and administrative action; and

(ii) on the multilateral and bilateral intergovernmental level through agreements and administrative co-operation.

On the national level, two basic strategies are available: host states can institute a system of monitoring affiliated transactions according to at-arm's length standards, to imputed values or according to a regulated posted price. The problem is here of how to avoid excessive administrative costs and obstacles and to institute an efficient and simple audit procedure. It is suggested - in line with the recommendations of the UN expert group 3/ that the mechanisms outlined below for bilateral and multilateral tax co-operation could provide developing countries with some of the expertise and information needed. In addition, there is certainly a need for UN-sponsored technical assistance built on in-house capabilities. In the context of monitoring systems, emphasis should be laid on ex-ante methods which set down rules eliminating some potential for abuse, e.g. rules prohibiting the allocation of overhead costs created outside the host state. 4/

Another strategy would recognize the problems involved in checking individual transactions and would employ a global approach - parallel to the global system of TNC operations - for tax assessment of intra-enterprise transactions. Taxable income

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1/ Cf. Lall, S., Transfer Pricing, 1978, report for the Joint Study; Irish, Ch., Taxation, Tranfer Pricing and Fiscal and Non-fiscal Incentives, 1979, report for the Joint Study;

2/ Cf. UN Doc. E/1978/36 of 6 April 1978;

3/ Cf. a Manual for the Negotiation of bilateral tax treaties between developed and developing countries, which has been submitted in 1979 to a drafting committee set up by the Group of Experts to finalize the text. This manual will deal, inter alia, with procedural arrangements regarding income and expense allocation, including transfer pricing, between related entities;

4/ Cf. Vaitsos, Money as a Negotiable Input in International Business Activities, paper presented at the roundtable on negotiations with TNCs at Yale University, April 1978.

would hence not be assessed on individual transactions, but on the share of TNC business in a respective host state. Income would, therefore, be apportioned, e.g. on the basis of sales, employment or other easily operationalized criteria. 1/

Another promising and complementary avenue for reducing the negative effects of abusive transfer pricing would be through intergovernmental co-operation, be it in the South/South context or between developing countries and industrialized countries. Regional co-operation could cover negotiations for tax treaties with industrialized countries, the use of apportionment formulas and standard assessment procedures. In addition, it could cover a system of exchange on tax information and joint audits of TNCs operating within the region. In the North/South context, it is proposed to prepare for the negotiation of a Code of Conduct on International Taxation. 2/ Such a Code would contain principles for behaviour of TNCs regarding the tax payment to host countries, principles of co-operation for industrialized countries and developing countries regarding the taxation of corporations operating in those countries, and a machinery for consultation. 3/ In view of the often effective tax co-operation among several industrialized countries, which is based on formal and informal mechanisms, the promotion of such inter-governmental tax co-operation should have priority.

9.6 Mechanisms for Developing Countries' Controlled External Funding.

Control exerted by foreign investors and in particular TNCs over investment in developing countries has been exercised in various forms. Most prominent among these forms have been dominating access to technology and to foreign-sourced funds. To increase developing countries' capacities for control over investment it is hence advisable to improve control over foreign funds for investment. 4/ The most promising way of doing so is to co-operate with foreign funding sources, in order to induce sources to make funds available to projects selected on the basis of their outstanding contribution to development. It is suggested to create, therefore, a regional guarantee

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1/ At the Seventh Meeting of the Group of UN Experts, reference was made to a paper entitled "Reflections on the Allocation of Income and Expenses among National Tax Jurisdictions, prepared by a consultant for the Eleventh General Assembly of the Inter-American Centre of Tax Administration in 1977; this paper explored also the allocation method of dividing the overall profits among tax jurisdiction;

2/ Cf. Report by the Group of Eminent Persons, The Impact of the Multinational Corporations on Development and on International Relations, ST/ESA/6 of 1974, p. 89, which recommends to consider the feasibility of an international agreement on the rules concerning transfer pricing for purposes of taxation; at present, the UN Expert Group is considering the possible conclusion of a multilateral tax agreement;

3/ The need for such a forum has been emphasized by the Seventh Report of the UN Expert Group, at p. 57 ff, ST/ESA/79 of 1978;

4/ Cf. para 61 (b) of the Lima Plan of Action.

for industry association (REGINA). [1] A clear quid-pro-quo would be incorporated in the operations of REGINA. Foreign funds would be channeled to projects controlled by REGINA, with repayment secured by guarantees made available through this body.

In addition, guarantees are called for, as the patterns of investment have increasingly led to a scarcity of risk-bearing funds for projects. If developing countries do not want to fall back to traditional patterns, they have to support an even higher flow of capital with features comparable to this type of capital. A common form of substitute class of capital would be funds guaranteed by a body like REGINA.

REGINA's operations may be outlined as channeling guarantees through a developing country's regional association. Developing countries' members of the association would provide against commercial risks preventing repayment and possibly conversion and transfer of funds. They would cover funds to projects with an approved benefit to the developing economy of one of REGINA's member countries, which otherwise would not be financially viable.

To fulfil its task of transforming portfolio or other non-equity funds to risk capital, the principle targets for REGINA's guarantees are:

- investment by foreign small-and medium-sized companies which do not have the means to put up sufficient risk capital;
- domestic investment relying to all or a large part on the contribution of foreign contractors;
- other forms of non- or quasi-equity investment.

In addition REGINA's guarantees may help to assist the funding of domestic majority shareholdings of formerly foreign direct investment, i.e. act as a supportive mechanism for transition to national control.

The guarantee extended by REGINA may thus avoid management problems induced by funds under foreign control. Participating countries in the scheme of REGINA may thus:

- increase their control over foreign financial flows and especially may have a say in how funds are used;
- increase their control over indebtedness in general, i.e. on the country level which can seriously inhibit financial capacity of a developing country; and

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1/ Cf. for a detailed proposal the report by Stockmayer, A., for this study, Vienna, August 1979.

- may increase their control over financial structuring of projects, which has a profound influence on the financial performance of an investment in the developing country.

Guarantees granted by REGINA to funds for projects will be made available by member states of the region and by industrialized countries. Industrialized countries may participate in REGINA by supplying guarantees or funds. However, if REGINA proposes a project to be guaranteed, they are restricted to either approve or refuse the project entirely. This way, participation will in each case reflect the specific interest of an industrialized country in a particular project. On the other hand, decision making and supervision of projects will entirely remain with REGINA and its governing bodies. REGINA-supplied guarantees will act as an incentive to foreign sources as well as to industrialized countries' guarantee or finance schemes. REGINA will have the technical means and political competence to evaluate chances and risks of projects. It will also monitor the project. In cases of severe difficulties, it will have the right to intervene with appropriate steps to rescue a project. This way the probability of failure and the ensuing incapacity to service debts will be kept to a minimum.

CHAPTER 10: INCENTIVES FOR INVESTMENT AND CO-OPERATION

Taxation is an important instrument of all governments to influence the development impact of industrial enterprise co-operation. Of particular interest is the correlation between fiscal incentives offered by the host state and the development performance of a co-operation project. Fiscal incentives are widely used to attract foreign investment. It is questionable if they are able to exercise any substantial impact on the foreign investment decision of the investor. 1/

However, it is certain that DCs often compete with each other and that the incentives provided largely cancel each other out. Incentives, therefore, often produce little effect except reducing the revenues for DCs' treasuries. Incentives are at present primarily used for attracting investment, but not, as it should be, to direct investment and industrial co-operation according to the national industrial development objectives. The challenge is how to reduce the costs of fiscal incentives to DCs and how to make them more effective in improving industrial co-operation performance with foreign enterprises.

On the national level, DCs should consider greater use of direct grants as opposed to fiscal incentives. They should be administered by the government agencies directly responsible for implementing the economic and social objectives underlying the incentives. Of particular importance is the employment of incentives as an effective instrument in directing co-operation on the project level to meet national development goals. Accordingly, the incentives should be tied contractually to a precisely designed developmental performance program for individual projects. 2/

In case such performance targets are not reached, there should be an obligation of the foreign enterprise to repay the incentive. Such repayment obligations should be secured by effective enforcement procedures, e.g. recourse to arbitration and particularly by incentive repayment bonds. Also, incentives should be granted on a preferential basis to these forms of non-equity co-operation which are considered less problematic than direct foreign investment. Of great importance is the simplification of tax incentive programmes. By making it easier for enterprises to take advantage of incentives, small-and medium-sized firms, particularly from other DCs, will be better able to enter the DCs' market at conditions comparable to those of TNCs. Fiscal incentives, however,do not seem to have the same success in attracting foreign enterprises as non-fiscal incentives, such as the stability of the environment of co-operation.

1/ Cf. Irish, Taxation, transfer pricing and the fiscal and non-fiscal incentives, 1979, report for the Joint Study.

2/ E.g. schedules for creation of jobs, foreign exchange earnings, increased national retained value, industrial integration of development of natural resources.

The measures discussed to deal with the stability issue have, therefore, to be seen also in the context of incentive policies. Of particular interc would be the provision of a simplified and accelerated procedure of comprehensive administrative decisions regarding industrial co-operation activities. Technical assistance to reduce "red tape" and to improve the efficiency of national administration promises is more effective than fiscal incentives. In addition, such a policy would be less costly for DCs and even would increase their bargaining abilities.

On the regional level, regional co-operation among DCs in dealing with foreign enterprises would appear to be imperative for almost all DCs in order to reduce the mutually negative impact of incentive competition. It is proposed to elaborate, in conjunction with the UN Group of Tax Experts, model regulations and uniform administrative procedures. These should discourage proliferation of costly fiscal incentives which are generally considered only secondary in effecting investment policies. Model regulations, as proposed, eventually could be transformed into a multilateral agreement on a regional level. A long-term goal would be a compensatory payment system which would discourage incentive competition among DCs. Increased government revenues, obtained through a regional reduction of fiscal incentives would be proportioned inversely to the relative increase in foreign investment.

On the intergovernmental level, particlarly in relation to home countries of TNCs, DCs should make certain that the benefits of their fiscal incentives do not service the treasuries of the investors' home countries. 1/

The most practical and immediately possible proposal would appear to continue the drawing up of bilateral tax treaties for avoiding double taxation. 2/

In such treaties, ICs should obligate themselves not to take any measures affecting the effectiveness of DC tax incentives without proper consultation. DCs and ICs could stipulate in such bilateral inter-governmental agreements that both tax systems will give full effect to agreed upon tax incentives for agreed upon co-operation projects for an extended period of time. In this context, mixed commissions could select and approve joint co-operation projects to benefit from such tax incentive stability. Particularly, ICs should refrain from suddenly destroying fiscal stability

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1/ In this respect it is worth recalling GA Resolution 3361 (S-VII) of 1975, at IV, 6 "Developed countries should, whenever possible, encourage their enterprises to participate in investment projects within the framework of development plans and programmes of the developing countries which so desire."

2/ Cf. here the cited work of the Group of UN Tax Experts.

granted by DCs and relied upon by co-operating enterprises through a revision of their foreign tax regulations. Also, ICs and DCs could jointly create a legally binding quid-pro-quo package between the grant of tax incentives and the respective counter commitment for development performance. The proposed Code of Conduct on International Taxation could as a multilateral intergovernmental instrument set forth such principles of intergovernmental tax co-operation.

The UN system could provide technical assistance to DCs through the discussed model regulations, and guidelines for tax incentive co-operation, but also through the design of incentive contracts which tie fiscal incentives to developmental performance.

CHAPTER 11: MARKETING CO-OPERATION AND EXPORT PROMOTION

11.1 Marketing Co-operation and Buy-Back Arrangements

The contractual arrangements for industrial enterprise co-operation can be developed into powerful vehicles to increase developing countries' capacities to find marketing outlets for manufactured products. The basic idea is to use the leverage given through the purchase of industrial plants and the control over natural resources vital to ICs' economies to exploit the foreign enterprise's marketing potential in areas where the DCs cannot expect to develop an independent international marketing system. This potential can be expected through packaging the supply of natural resources vital to ICs' economies (e.g. petroleum, uranium, minerals) with respective commitments to market and import processed resources e.g. linking the supply with petroleum to the supply with petroleum derivates. 1/

Another method is through marketing co-operation. The concept behind such marketing co-operation is to create a package between the purchase of industrial plants and technology and corresponding co-operation by the foreign enterprise in marketing. 2/

A first step would be the foreign enterprises to authorise the entry of DCs' exports into other markets from the respective plant production. This could lead to some forms of market sharing. However, it is often the specific marketing know-how, the existence

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1/ Such a policy would seem to need implementation on the enterprise level through respective supply packages and on the intergovernmental level, i.e through DC commitments for security of supply in exchange for IC commitments for security of processed natural resources to IC markets.

2/ Cf. UNIDO Doc. ICIS.68, 1978, at p.67; the various forms of marketing co-operation in the East/West context are discussed in the ECE Note, Marketing aspects of east/west industrial co-operation contracts, TRADE/Sem.4/R.1 of 16 February 1979.

of a well-established system of marketing, servicing and maintenance, which is crucial for successful exports. Accordingly, market co-operation should proceed to an agreement on marketing assistance e.g. relating to servicing and maintenance crucial for successful exports. Accordingly, market co-operation should further proceed to an agreement on marketing assistance (e.g. relating to servicing, maintenance, joint use of established marketing channels, use of trade marks) and finally to marketing joint ventures, where the production from the respective plant is jointly marketed in specific markets.

Also, industrial co-operation can envisage forms of buy-back or barter arrangements as practiced primarily in East/West relations . 1/

Barter and related compensation arrangements 2/ provide for a payment for industrial transactions in products not necessarily related to the supplied plant or technology, while a buy-back system implies that all or part of the remuneration for the supplier of plant and technology is achieved through a share production. In natural resources exploitation (petroleum, coal, uranium), the production-sharing has been used to remunerate the investor or service contractor; this system is closely related to industrial buy-back arrangements. Barter agreements are frequent in East/West, East/South and South/South relations as they are an instrument to economize foreign exchange expenditures. Buy-back arrangements, which seem to offer distinct advantages over simple barter, are used primarily in East/West relations, but also in East/South relations. 3/

Disadvantages of buy-back systems are the dangers of overpricing plant and technology and some market limitations for the recipient country, but, on the other hand, the buy-back systems create a strong incentive for the foreign enterprise to ensure proper plant performance. They also allow for the economies of scale and indirect market penetration. Another advantage is that the amount of investment can be increased through financing inherent in buy-back.

1/ Cf. ECE Analytical report, Doc E.73.11.E.11 at P.911; UNIDO, Report on the Expert Group meeting on buy-back agreements, Doc. UNIDO/Ex.78 of 17 April 1979.

2/ For a classification cf. UNIDO, New channels for financing industry from commercial sources, Doc. ID/WG.287/5 of 8 November 1978.

3/ E.g. several natural resources development projects by the USSR with payment in resultant products. Cf. Mohr, Buy-back-study, report prepared for UNIDO, 1979.

It seems, therefore, that various forms of marketing promotion through industrial enterprise co-operation should be encouraged. Accordingly several measures could be taken to promote marketing co-operation and buy-back arrangements:

- A manual on marketing co-operation could be drawn up containing guidelines and model provisions related to the negotiation of marketing co-operation arrangements (market sharing, marketing assistance, joint marketing ventures)

- a manual on buy-back arrangements could be drawn up, covering buy-back contracts, e.g. quality norms and standards, quality control, terms of delivery, delay and quality fines, distribution restrictions, producers liability, arbitration

- the proposed UNSRIC-arbitration could serve as a forum to solve the various forms of disputes likely to arise out of buy-back contracts

- the preparation of methods to set up common clearing accounts with built-in exchange facilities (Cf. the intra-CMEA system of a transferrable rouble and the common clearing account method used in East/South co-operation.)

- a feasibility analysis of an international guarantee fund for buy-back arrangements.

11.2 Export Promotion Policies

Another way of increasing the export potential of foreign investment is through improved export promotion measures. 1/ In this respect, subsidies by developing countries often are ineffective because of contradiction to ICs' import policies. Equally, competing mechanisms of other DCs are often threatened to be cancelled by export promotion incentives. Here it may be more beneficial to replace competition with a negotiated framework of mechanisms allowing DCs to supplement one another. Remedial measures are needed to distribute more equitably the burden of incentives. As export promotion grows increasingly expensive, DCs will no longer be able to afford it on their own. ICs should be asked to share the costs as foreign investment will benefit ICs through international taxation. Two methods of improving the export potential of foreign investment in DCs, namely (1) a consultation service for market-related export promotion and (2) a bilateral exchange of commitments between DCs and ICs relating to access of DC products to IC markets versus a protection of IC foreign investment in DCs through intergovernmetnal agreements under the quid-pro-quo approach have already been explained. Specifically, the study proposes two mechanisms for export promotion:

1/ Cf. for a detailed analysis the report by Kebschull, 1979 for the Joint Study.

(i) Negotiation rounds on a regional level on harmonization of export promotion will serve a twofold aim. First, they will create a forum of discussion and exchange of information on the effects of national export promotion measures. The second aim would be an effort to avoid duplications incentives, countervailing incentives and, more generally, measures adversely affecting policies of other states in a similar position. By gradually harmonizing incentive measures the participating developing countries will gradually come close to setting up a common export strategy.

(ii) An international export financing scheme, set up concurrently with the mechanisms mentioned, but in co-operation with industrialized countries, will respond directly to the need for more financial support for exporting enterprises. Until now, mechanisms proposed, such as the UNCTAD-supported Export Credit Guarantee Facility, have not been dealing with the financing problems for South/North and South/South exports. These types of export promotion may well be a particularly worthy target for financial support:

- Smaller firms, such as those investors from developing countries are mostly catering to, often lack the necessary financial means to conquer a new export market, even if it has specific advantages;
- incentive measures for South/North and South/South export promise relatively quick results in terms of foreign exchange earnings, which will in turn help foster industrial development.

The mechanisms suggested will encompass the characteristics of the Export Credit Guarantee Facility with its principal advantages stemming from the multilateral approach. A need for national schemes will be substituted for by the multilateral solution which will include the granting of subsidies, which has not been envisaged in the current proposals for the ECGF. The subsidies which would be financed either bilaterally by the exporting developing country and the importing industrialized country or by a multilateral authority on a regional basis which would create funding conditions comparable to the conditions extended by industrialized countries to their exporters. The rationale behind this proposal is to place exporting developing countries at an at least equal competitive level with exporting industrialized countries.

It could be the UN System's task to sponsor negotiation rounds on a regional level on export promotion and on the creation of an international export financing scheme.

CHAPTER 12: METHODS AND MECHANISMS FOR PROMOTING INDUSTRIAL ENTERPRISE CO-OPERATION AMONG DEVELOPING COUNTRIES

Industrial co-operation among developing countries fulfils a prominent function in the process of the establishment of a New International Economic Order.[1/] It is an instrument to diversify and replace Third World countries unilateral dependence on the industrialised world and on TNCs as transmitting agents, to open up new markets, to effect a balanced and new international division of labour and to increase industrial opportunities through and for regional economic integration. There is evidence that the developing countries' traditional North/South economic ties are gradually giving way to greater co-operation with other DCs.[2/] However, industrial co-operation among DCs is still meeting serious obstacles which the pertinent resolutions of international conferences (Lima, 1975; Mexico, 1976; Nairobi, 1976; Buenos Aires, 1978; Arusha, 1979; Manila, 1979) have not been able to overcome. The task is to search for concrete and practical policies which can transform general exhortations into effective levers promoting industrial enterprise co-operation among DCs. The present chapter does not pretend to offer overall guidelines for such promotion policies. However, it attempts to deal with some specific legal issues involved in overcoming obstacles which confront industrial co-operation among DCs on the enterprise level. This approach does not imply that the methods and mechanisms already discussed are not applicable to industrial co-operation among DCs; these issues are certainly relevant in the context of industrial co-operation among all the various partners involved. The present chapter, however, is concerned with very specific issues and mechanisms relevant particularly for policies promoting industrial enterprise co-operation among DCs.

The obstacles which will be dealt with here concern the often complicated, different and sometimes discriminatory legal environment of host states for industrial co-operation projects. Even among countries of a similar cultural identity and similar

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1/ Cf. the authoritative UN GA Res. 3201; para 60 of the Lima Plan of Action; report on the Mexico Conference on Economic Co-operation among DCs, UNCTAD Doc. TD/B/628 of 7 October 1976; UNCTAD Doc. TD/244 of May 1979; for relevant documents reflecting the evolution of the concept of ECDC in the context of the non-aligned movement see Jankowitsch/Sauvant, The Third World without Superpowers, 1978.

2/ See particularly the contributions by Diaz-Alejandro and Wells in Agmon/Kindleberger (ed), Multinationals from Small Countries 1977, and P. O'Brien, et. al., Direct Foreign Investment and Technology Exports among DCs, January 1979, report for the Joint Study.

cultural identity and similar economic systems, co-operation has often been hindered by such obstacles.[1/] The development of specific foreign investment codes and pertinent regulations - basically oriented at regulating the access of TNCs to national economies - in recent years often has not limited TNCs. These enterprises have been sufficiently large and experienced to cope with new regulations. However, the increasing scope and complexity of foreign investment regulations and of the administrative procedures has strongly hindered smaller enterprises from other developing countries. These enterprises often lack the skill, experience, coverage and size to overcome the barriers which have been erected with large TNCs in mind.[2/]

Another obstacle is to be found in the attitude of developing home states which often have been wary of providing the necessary authorisations for investment transcending their national borders, primarily to prevent flight of capital and foreign exchange.[3/]

It is these specific roadblocks against industrial enterprise co-operation among DCs to which the proposed methods and mechanisms are addressed. They rely to a considerable degree on respective policies undertaken within the regional economic integration efforts of developing countries (e.g. the Andean Pact and the Caribbean Common Market), but also on the policies of legal harmonisation which have accompanied economic integration in the CMEA, the EC and the US. One cannot simply mimic mechanisms tried elsewhere but has to adopt tried concepts and methods to the specific problems faced by developing countries' industrial co-operation objectives. Basically, three approaches are suggested:

1. Step-by-step policies of uniformisation of the legal framework of industrial co-operation on a regional basis, supported and promoted by the UN system, particularly the UN Regional Economic Commissions with a global co-ordination.[4/]

2. The elaboration and promotion of organisational structures ("Model corporate statutes") for incorporation into regional joint enterprises' statutes or even for direct application through an international corporate statute. This approach is to facilitate the establishment and the operations of regional joint, i.e. "multinational", enterprises.

1/ Cf. Ghezali, Les Sociétés 'Multinationales', Instrument de Co-opération Sud/Sud, Algiers, 1979, report for the Joint Study; Instituto para la Integración de America Latina (INTAL), Las Empresas Conjuntas Latinoamericanas, version preliminar, 1977, at p. 153 ff.; see also UNCTAD, The Scope of Trade Creating Industrial Co-operation at Enterprise Level between Countries Having Different Economic and Social Systems, E.75.II.D.16, p 16, 20.

2/ Cf. also O'Brien P., et. al., Direct Foreign Investment and Technology Exports among DCs, op. cit., p. 40f.

3/ Cf. INTAL, Las Empresas Conjuntas, op. cit., p.154.

4/ See also para 60 (k) of the Lima Plan of Action.

3. Methods for collective bargaining among DCs.

12.1

Regional Harmonisation of the Legal Framework for International Industrial Co-operation

A gradual harmonisation of the laws and regulations pertaining to industrial co-operation should reduce those obstacles to South/South co-operation, which are primarily based on discriminatory and complicated regulations and on procedures oriented primarily at TNC activities. The concept of legal harmonisation among DCs on a regional basis is based on two assumptions:

1. The present scope available to TNCs to employ divisive strategies vis-a-vis DCs e.g. incentive competition has to be reduced and gradually to be replaced by some forms of a common DCS stand 1/

2. Co-operation among DCs, being hampered by many obstacles and being in an unfavourable competitive position vis-a-vis TNCs should obtain preferential treatment and positive discrimination.

Another important function of legal harmonisation is its contribution to regional economic integration. This is of particular importance for DCs, many of which do not have economic systems of sufficient size to be economically viable in the long run. Experience in several regional economic integration developments suggests that legal harmonisation has been an essential ingredient for regional integration and co-operation.2/ The economic integration process in Latin America, particularly, but not exclusively, through the relatively young Andean Pact, is accompanied by a considerable evolution of a harmonised legal framework for transnational business operations.3/

1/ The proposals addressed at the issues of transfer pricing and investment incentives have also to be seen in this context, see supra chapter 10.

2/ It is difficult to make any definitive judgement whether legal harmonisation is instrumental to regional integration or only an accessory, accompanying phenomenon; however, that most regional integration schemes observed go hand in hand with legal harmonisation indicates that legal harmonisation has some positive role to play - even if its precise role is difficult to ascertain.

3/ This process has been very well documented, particularly through the important works of the Instituto para la Integracion de America Latina (INTAL) and its Revista de la Integracion; cf. INTAL, La dimensión juridica de la integracion/ America Latina, 1973; INTAL, Associacion internacional de empresas on America Latina, 1974; Rioseco, El marco juridico de la ALALC y su flexibilidad para adaptarse a nuevas circumstancias del proceso de integracion, Derecho de la Integracion, XI (1978) 11 ff.

Such harmonisation is concerned particularly with common rules for foreign investment, with transfer of technology and with the establishment of "empresas multinacionales".

A similar movement can be observed in the Council for Mutual Economic Assistance (CMEA), where the fundamental "Comprehensive Programme" of 1971[1/] assigns to "the approximation and unification of relevant national legal norms" a prominent place in promoting socialist integration.[2/]

Legal harmonisation and unification has progressed in accordance with the 'comprehensive programme', particularly through general or uniform terms on dispute settlement, on international passenger carriage, on deliveries of goods on sale of equipment and of respective servicing and maintenance; on contractual types of economic, scientific and technical co-operation and on intergovernment planning instruments.[3/] The method of legal harmonisation in the CMEA has been to advance gradually from model terms and codes of a non-mandatory character for voluntary incorporation, to be tested for some time to mandatary and multilateral uniform rules.[4/]

In the case of the European Community (EC), a corresponding development can be observed. Based on Art. 54 III and Art 1000 of the Treaty of Rome, the Commission has developed a considerable range of activities to harmonise the rules governing economic activities transcending the national borders and relevant to the process of economic integration.[5/]

1/ Cf. Progress Publishers, The Multilateral Economic Co-operation of Socialist States, 1977, p. 46 ff.

2/ Cf. Autorenkollektiv Seiffert et al., Das System rechtlicher Regelung der sozialistischen ökonomischen Integration, 1976, p. 35 ff.

3/ Cf. Butler, A Source Book on Socialist International Organisations, 1978: Autorenkollektiv Seiffert, op. cit.: Progress publishers, op.cit.: Uschakow, Vereinheitlichung des Kaufrechts im Ost/West Verhältnis, 1978; on investment co-operation in the CMEA see also Kraft, Die Zusammenarbeit der Mitgliedsländer des RGW auf dem Gebiet der Investitionen, 1977.

4/ See for the method of CMEA legal harmonisation Uschakov, Integration und gemeinsame Betriebe in RGW, in Recht in Ost und West, 1979, 50; Autorenkollektiv Seiffert, op.cit., p. 30 ff.

5/ Cf. Ipsen, Europäisches Gemeinschaftsrecht, 1972, p. 687 ff. This harmonisation has been directed particularly at harmonising the law business entities (corporations, enterprise co-operation; it has been supplemented by the creation of autonomous European law, particularly in the area of competition. Cf. Mestmäcker, Europäisches Wettbewerbsrecht, 1974.

The method of harmonisation has basically been the directive to member states (ART. 189 III of the Treaty of Rome), but also Recommendations (Art. 27), a regulation with direct effect (Art. 43II, 49) and multilateral conventions in exceptional cases (Art. 220). In addition, one should bear in mind the economic integration history of previously disintegrated economic systems - such as the states of the US or the German states grouped together in the German "Zollverein" in the 19th century - where economic integration has been accompanied by a growing body of uniform law regulating inter-state commerce, be it through harmonisation of state laws or by the creation of a new, uniform, federal law on inter-state commercial activities.[1/]

With reference to these successful experiences of legal harmonisation, it is suggested that the UN system and developing countries should pay more attention to promoting harmonisation on the regional level than the global where the slow moving processes of UNCITRAL have demonstrated the difficulties of finding a consensus. Particular emphasis should be given here to grant preferential treatment to industrial enterprise co-operation among developing countries. It is evident that this has to be a long-term process - which is already taking place within several regions (e.g. the Andean Pact or the ALALC, the CARICOM, the ASEAN countries), but which requires assistance and promotion through the provision of model instruments, regional and global consultations, promotion of adequate institutional infrastructure. Some specific issues will be highlighted in the following section. They certainly do not express the gamut of legal harmonisation in regional economic integration, but attempt to select major issues relevant to industrial co-operation on the enterprise level:

> Investment and industrial co-operation regulations and procedures: model codes regulating foreign investment and industrial co-operation should be elaborated on a regional level. Therein, privileged treatment should be granted to all kinds of co-operation with other regional countries. Such privileges - at present often found in specific project agreements[2/] could consist of simplified procedures for registration and authorisation, avoidance of double taxation, specific tax exemption, privileged access to markets of countries whose companies participate in the venture, specific guarantees to tax stability, national treatment, privileges related to foreign exchange regulations.[3/]

1/ For an extensive analysis of harmonisation of the EC's company law systems cf. Lutter, Europäisches Gesellschaftsrecht, 1979.

2/ Cf. the Colombian/Venezuelan 'Monomeros Venezolanos', joint project, Londono/Vega, Derecho de la Integración, 25/26, 1977, p. 87f.

3/ Cf. Carreau, Etude juridique de la contribution des investissements privés à l'industrialisation des pays en développement, February 1978 - manuscript, p. 27.

- Harmonisation of tax incentives, tax regulations and tax administration (supra. chapter 10)

- Harmonisation of environmental and consumer protection legislation in order to reduce unpredictability of regional co-operation and reduce respective non-tariff barriers.

- Harmonisation of the law relating to the international sale of industrial equipment. Such harmonisation could be coordinated and eventually evolve into uniform terms for the specific areas of industrial co-operation. It could rely to some extent on the efforts undertaken by the ECE and by the CMEA.

- Harmonisation of corporate law. An important obstacle for regional industrial co-operation is the variety of corporate laws and each country's individual requirements concerning incorporatinn, registration, corporate organisation, disclosure and liabilities. It is suggested that a gradual harmonisation of important areas of corporate law relevant to regional industrial co-operation should be furthered. The ultimate goal would be a uniform company code within the region. 1/ Harmonisation efforts should be co-ordinated with the proposed model code for foreign-controlled subsidiaries (supra). The harmonisation efforts should be addressed specifically at the following issues: incorporation, registration and regional recognition of companies, minimum capital requirements, liability to creditors, parent-subsidiary relations, issues of stock and bonds, disclosure, corporate organisation (stockholders assembly, management board, administrative council), workers and public interest representation.

In the context of regional legal harmonisation, the notion of 'regional industrial co-operation' should be clearly defined. The purpose would be to exclude locally incorporated, but extra-regionally controlled enterprises from enjoying the preferential benefits to be granted. 2/ Otherwise, it would be mainly non-regional TNCs which could benefit from such legal harmonisation and privileged treatment for regional enterprise co-operation. This would be counter to the principle of material preferential treatment for regional enterprise co-operation.

1/ Cf. the cited EC harmonization directives directed at corporate law according to Art. 54 IIIg of the Treaty of Rome.

2/ Cf. Art. 8 of the Decision 46 of the Andean Pact, see Grigera-Naon, Transnational Enterprises Under the Pacto Andino and National Laws of Latin America, Contribution to the Bielefeld symposium on Codes of Conduct, July 1979, p. 7 ff.

12.2

An International Corporate Statute for Regional Joint Enterprises

The creation of regional and inter-regional enterprises capable of promoting co-operation among DCs and capable of competing with - or be an equal partner of - TNCs, has been called for at several recent international conferences. [1] Joint regional enterprises can fulfil, inter alia, the following functions: [2]

- Increase regional economic co-operation and integration.
- Become an instrument for collective bargaining (e.g. collective purchase of technology. [3]
- Increase the leverage of sellers (commodities, manufactured products) through joint entering of ICs' markets.
- Jointly float bonds and increase access to ICs' capital markets through joint banking.
- Jointly insure DCs' larger scale projects.
- Be the appropriate form for co-operation among state enterprises. [4]

1/ Cf. Mexico Conference on Economic Co-operation among DCs, III, 2, at p. 22, UNCTAD Doc. TD/B/628 of 7 October 1976; the thereto related Conference of African Ministers called for the promotion of multinational industrial, livestock and fisheries, transportation enterprises, UNCTAD Doc. cit. annex IX, p. 10ff.; See also the Lima Plan of Action, para 60(m); similarly, a meeting of high-level experts on ECDC recommended support by international agencies and direct promotional efforts for multinational enterprises and specified areas suitable, cf. UNCTAD/UNDP Project INT/77/019 of 12 January 1979; for multinational marketing and production enterprises, cf; also UNCTAD Doc. TD/244 of May 1979 p. 23 ff. and Doc. TD/B/C.H 28 of 18 January 1979.

2/ See Vaitsos, La funcion de las empresas transnacionales en los esfuerzos de integracion economica en America Latina, UNCTAD Roundtable, Lima, 12 June 1978, TAD/EI/SEM.5/2, p. 26.

3/ See Bhandari, Co-operation among State Trading among State Trading Organisations of Asian DCs, UNCTAD Doc. TD/B/C.7/17 of 18 September 1978, p. 41 f.

4/ See for Latin American illustrative examples Mateo/White, Las empresas publicas ..., op.cit., Revista de la Integración, 1974, No. 16, p. 71ff.; cf. also UNCTAD Reports TD/B/C.7 - 16-17-18, Add. 1 and Add. 2.

- Regional joint enterprises could be the appropriate form for tripartite joint undertakings (e.g. East/West/South) where a harmonisation of co-operation methods is useful. 1/

- Regional joint enterprises could also be the appropriate form for regional investment and performance insurance institutions proposed (see infra).

In order to give effect to the concept of regional joint enterprises, there is - apart from promotional and informational efforts - 2/ a need to advance from mere exhortation to the proposal of concrete methods and mechanisms to reduce obstacles and to provide a suitable organisational and legal framework for such regional joint enterprises. 3/

A survey of existing practices in regional integration efforts yields the concept of an internationalised corporate statute as an appropriate form to promote and to favour joint enterprises which are viewed as vehicles for such integration objectives. In order to reduce some of the political frictions faced by intra-regional co-operation 4/ there is the possibility of creating a supranational/regional corporate citizenship by a multilateral treaty. In other words, it is suggested that an international enterprise law on a regional level should be established. Such a law would be administered by a regional body, which would exercise domiciliary supervision, but also enforce the integration objectives of the respective regional member countries. This regional law would imply that member states accept that guidelines to be issued by the regional body limit them in imposing restrictions on companies so chartered. 5/

1/ Cf. UNCTAD Doc. E.75.II.E, 16, p. 20, UNCTAD Doc TD/243/supp. 5 of May 1979

2/ Cf. a number of consultants' studies on regional joint ventures issued by the UNCTAD Secretariat, e.g. Agrawal, Joint Ventures Among Developing Asian Countries, TD/B/AC.19/R.5; Shihata, Joint Ventures Among Arab Countries, TD/B/AC.19/R.5; Joint Ventures Among African Countries, Okigbo, TD/B/AC.19/R.3; Casas-Gonsales, Joint Ventures Among Latin American Countries, TD/B.AC.19/R.2; cf. also UNCTAD's compilation of the principal legal instruments on ECDC, TD/B/609 - Add. I, Vol. I-VI and INTAL, Asociación internacional de empresas en America Latina, 1974.

3/ Cf. for some juridical aspects UNCTAD Docs. TD/B/C.7/28 of 18 December 1978 and Doc. TD/B/C.7/30 of 7 May 1979.

4/ Cf. Ghezali, Les Sociétés multinationales - instrument de Coopération Sud/Sud, op.cit.

5/ Such a proposal has been put forward by Ball G., Multinational Corporation and the Future of the World Economy, in Global Companies, the Political Economy of World Business, Ball G., (ed.) 1975, 167, for what is called here "TNCs". However, our modification of this suggestion is directed at privileging not TNCs, but only "multinational-regional joint enterprises" among DCs by such a regional/international charter and enterprise law.

The proposal is by no means unique: the Andean Pact has, by virtue of Decision 46, established "empresas multinacionales" which are joint regional enterprises recognized and privileged in all regional member countries. Control is exercized by the supervising country, where the "empresa multinacional" is formed. They will benefit from the Cartagena agreement's liberalization programme in respect to tariffs, customs duties, taxation and importation. They are entitled in the regional countries to national treatment. They have other privileges in comparison to non-regional enterprises with respect to access to government contracts and to the Andean Pact's restrictions on foreign investment by virtue of Decision 24. 1/ Similarly, the Caribbean Community (CARICOM) has, in 1976, established a joint regime for "Empresas Caricom". 2/

In the Council for Mutual Economic Assistance (CMEA), international economic organisations are promoted as the legal organisational form of socialist international division of labour through joint enterprises. Following "model conditions" in 1973, a respective CMEA directive to member countries obligating them to provide a legal framework for the activities of international economic organizations and in 1976 "uniform regulations" were issued. A model organizational statute and a contract model for such organization is under preparation. 3/

In the European Community (EC), a corresponding development can be observed concerning the evolution of a European corporations law, mainly by the respective harmonization directives under Art. 54 III g of the Treaty of Rome; in addition, the Commission has been working for a number of years on the project of a "European Company", i.e. a supranational company which is recognized as such in all member countries. 4/

1/ See for an extended discussion of the empresas multinacionales Grigera-Naon, op. cit., p. 6ff; up to now, apparently no enterprises have been set up under this system, inter alia this seems to be due to the fact that under Decision 113 subregional enterprises receive corresponding privileges;

2/ Cf. Derecho de la Integración, 25/26 (1977), 125;

3/ Cf. Autorenkollektiv Seiffert, op.cit., p. 110ff; Lorenz P., Multinationale Unternehmen sozialistischer Länder, 1978; Uschakow, Integration und gemeinsame Betriebe im RGW, Recht in Ost und West, 1979, 49ff. A number of international economic organisations have up to date been established.

4/ Cf. Vagts/Wilde, The Societas Europeae, Business Lawyer 29, 1974, 823.

The traditional form for establishing a regional or bilateral joint venture with state intervention was through a special inter-governmental project treaty setting up international bodies for project execution or at least for granting preferential treatment for private law project enterprises. 1/ The proposed "regional corporate statute/charter" should reduce the negotiating costs for establishing such inter-governmentally sponsored joint enterprises and provide a ready-made model for incorporation and modification. Specifically, it is proposed:

(i) Efforts to establish regional corporate statutes for intra-regional joint enterprises;

(ii) Conditions for preferential treatment to such regional joint enterprises;

(iii) Regional institutional bodies for the incorporation and supervision.

(i) An International/Regional Corporate Statute for Regional Joint Enterprises

A corporate or charter statute would have to be developed. As in the process of CMEA integration, one could advance from the elaboration of a model statute, itself exercising a persuasive effect, to respective non-binding, but authoritative recommendations and guidelines and finally to a regional convention setting up regional/international incorporation. Such a statute should contain at first the normal enterprise structures, e.g. corporate organisation, workers representation, registration, incorporation, recognition, rights and duties of management, parent-subsidiary relations, liabilities of creditors, disclosure, minimum capital and respective stock obligations. In addition, it would set forth specific requirements to justify the respective grant of preferential treatment to regional joint enterprises. Such requirements would attempt to direct such privileged forms of co-operation towards joint industrial development and integration goals, e.g. membership would only be open to enterprises which are resident, incorporated and materially controlled by governments and/or citizens of the regional countries. Functional and developmental requirements would aim at ensuring that from the enterprise's operations a positive contribution to regional co-operation and integration could be expected. In sum, the proposed statute would be the organisational and legal vehicle to put regional joint enterprises on a more equal footing with foreign TNCs. Such foreign enterprises would be precluded from using the regional statute's form.

1/ Cf. for the project of an "Air Maghreb" corporation, to be set up by an inter-governmental agreement to be implemented by an annexed corporate statute among three states participating Ghezali, op.cit.; Mateo/White, Empresas publicas, op.cit.; for the agreements setting-up intra-CMEA joint enterprises - International Investment Bank, International Bank for Economic Co-operation, Intermetall, Interkhim, Interelektro, Interatominstrument, Intertekstil'mash, Interatomenergo, Interkhimvolokno see Progress Publishers, op.cit. and Butler, Source Book on Socialist International Organisations, op.cit.; for a relatively comprehensive list of international economic organisations of Lorenz P., Multinationale Unternehmen sozialistischer Länder, op. cit., p.55ff.

(ii) Preferential Treatment

Some of the issues of preferential treatment for enterprises have already been discussed as methods for legal harmonization. A regionally chartered joint enterprise would be recognized in each member country without anything more than formal registration. It could be sued and would be able to sue in all countries as a national corporation. It would enjoy complete national treatment in all regional countries. It would have freedom - to the extent feasible - to re-invest and re-patriate earnings and capital. It would enjoy privileged treatment in respect to stability of investment, either by a most-favoured clause, by preferential rates for investment insurance under the proposed regional investment insurance scheme or by specific guarantees.

(iii)
Supervision of Regionally Chartered Joint Enterprises

Governments could - through a multilateral convention negotiated on a regional basis - undertake certain commitments vis-à-vis the regional joint enterprises which have applied successfully for the benefits of the regional corporate charter. Particularly, states would refrain from imposing restrictions other than those permitted under the convention on the regional joint enterprises so chartered. The principle would be to assure the ability of host states to maintain their national interests, but reduce to a minimum the administrative frictions and tensions which have proved such powerful roadblocks to effective intra-regional co-operation.

Such a privileged system would certainly have to be counterbalanced by a corresponding system of supervision. On a regional level - e.g. under the sponsorship of the UN regional economic commissions - a regional control board would be set up, composed of representatives of member countries. [1/] It would issue guidelines for admission to the regional charter and for continuous supervision. Such supervision would have to ensure that the regional joint enterprises would not employ practices criticized when undertaken by TNCs (e.g. political interference, transfer price abuses, disregard of national and regional industrial development plan objectives) and that the benefits of industrial co-operation are adequately distributed to the participating member countries. For purposes of conflict resolution, the proposed regional arbitration centres within the UN system for resolution of industrial conflicts would be available.

1/ Cf. the respective institutions of the Andean Pact or the European Court.

12.3

Methods for Collective Bargaining by Developing Countries

Another mechanism to strengthen developing countries' bargaining abilities would be through a considerable extension of the present co-operation in respect to bargaining with TNCs. 1/ It is in that context that the present study suggests the expansion and the development of several methods for increasing Third World bargaining abilities through collective action, e.g. particularly the concept of information-sharing on an informal and reciprocal basis and of a project and enterprise referral system for performance evaluation. (see infra chapter 3.4). In addition, the proposed regional charter for regional joint enterprises would be a natural form to facilitate the establishment of joint developing countries' enterprises for collective bargaining.

12.4

Other Mechanisms to Promote Industrial Co-operation among Developing Countries

A number of the previously outlined mechanisms are predominantly directed at fostering industrial co-operation among developing countries. This applies to the Regional Investment Insurance Corporations (RICOs), the Regional Guarantee for Industry Associations (REGINAs), the Contractual Liability Consortia (CLIC) and the programme to mobilise small- and medium enterprise co-operation with particular emphasis to be given to developing countries. All these mechanisms are aimed at reducing developing countries' dependence on corresponding institutions in industrialised countries and at placing enterprises from developing countries on more equal footing with the TNCs' supportive public framwork. They are equally intended to open channels of privileged industrial co-operation on a South/South level.

12.5

Efforts by the UN System to Implement the Mechanisms for Promoting Industrial Co-operation among Developing Countries

A step-by-step approach, building on existing practices, which has functioned well is suggested to implement the proposed legal methods for promoting industrial co-operation among developing countries. As in the CMEA practice, a first step would be the design on the global level of model corporate codes and model corporate charters with appropriate in-depth studies on present regional practice. In collaboration with the UN Regional Economic Commissions, a second step would be a modification and adaptation of such model instruments to the specific regional situations. Then, as a final step, regionally

1/ Cf. para 60 (k) of the Lima Plan of Action.

issued recommendations and guidelines for respective national action and legislation could follow. As intra-CMEA relations demonstrate, a considerable effect of harmonization can be reached through such policies, without that a legally binding instrument is required. As a long-range perspective, the negotiation of regional conventions, under the auspices of the UN Regional Economic Commissions, could follow which would finally produce binding regional harmonization and a legally full-fledged regional corporate charter. In that process, it would be the task of the UN system to develop and adequately support concepts and set a process of opinion-building and policy-making on the regional level into motion.

In addition, technical assistance for setting up respective corporations laws and regional joint ventures is necessary. 1/ All these efforts would fit into the framework of UN activities developed in the study. Through the proposed UN programme to support Third World bargaining abilities, the respective model instruments could be developed and assistance could be rendered; the UN Commission for Industrial Development Law would be the appropriate body for overall guidance and issuance of recommendations. The UN System for Resolution of Industrial Conflicts (UNSRIC) would be the appropriate forum for resolving disputes. With the facilities for technical expertise, contract adaptation, conciliation and summary proceedings, it could provide dispute settlement at the national, regional and even global level with the proper degree of flexibility built in.

1/ Cf. the respective recommendations by Bhandari, UNCTAD Doc. TD/B/C.2/17 of 18 September 1978, p. 55.

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RELATIONS BETWEEN TRANSNATIONAL CORPORATIONS AND THE DEVELOPING COUNTRIES

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CHAPTER 1: "RUN-IN"* CONTRACTS

Contracts for the supply of run-in plants made their appearance in industrial relationships between some enterprises in developing countries and transnational enterprises at the beginning of the 1970s. Thus they originated at a time when the types of co-operation that had been instituted after the accession to sovereignty of most of the countries formerly under colonial rule were being called in question.[1/]

It is not surprising, consequently, that the run-in contract should have been regarded by its protagonists, and in particular by Algeria, as a formula which could represent an improvement on the "turnkey" contract and an instrument for national economic development.[2/]

Run-in contracts should therefore be evaluated in comparison with turnkey contracts from the viewpoint of the establishment of an independent economy.

In other words, a study of the run-in contract formula should not only draw attention to differences or innovations in relation to the turnkey contract but also consider whether the new solutions envisaged are of such a nature as to promote economically independent development in the developing countries, and particularly in Algeria.[3/]

This means that, after a brief overall comparison of the two types of contract, the most important aspects of the run-in contract formula will need to be identified and analysed.

In addition, all run-in contracts provide for international arbitration as the procedure for settling disputes between the contracting parties. Run-in contracts usually make reference to the conciliation and arbitration rules of the International Chamber of Commerce (ICC). This is a form of international arbitration which, as will be seen in chapter 2, has become traditional in contracts between transnational corporations and developing countries.

From the point of view of legal structure, there is no important global difference between run-in contracts and turnkey contracts. Both are usually synallagmatic contracts balancing the rights and obligations of the parties.

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* Translator's note: The term "run-in contract" has been used throughout this section as the equivalent of the French term contrat produits en main, referring to contracts which go beyond "turnkey" arrangements in that they provide for the supplier of the plant, inter alia, to participate in its management during the running-in period.

1/ Cf. Henry, J.R., Mutation du droit international du développement: la France et l'Afrique, thesis for the Doctorat d'Etat in Law, University of Nice, October 1977.

2/ Cf. Judet and Perrin, Du contrat 'Clé en main' au contrat 'produit en main'.

3/ Concerning the concept of independent economic development, see Samir Amin, Le développement inégal, Edition de Minuit. See also Bettelheim, Ch., Planification et croissance accélérée.

In any event, in the relations between enterprises in developing countries and enterprises in industrialised, and principally market-economy, countries - the relations which are the subject of this study - turnkey and run-in contracts have as their two parties a foreign contractor consisting of an enterprise or group of enterprises, frequently transnational, and a customer consisting of an enterprise in the developing country concerned.

In both run-in contracts and turnkey contracts, the general objectives pursued and the obligations and rights of each party are set forth.

It may be said in a general way that the headings of many of the sections in these two types of contracts are similar.

The solutions adopted by the parties in different contracts are not, of course, always the same. Some turnkey contracts come very close to being run-in contracts, the designation "run-in contracts", or contrat produits en main, being used above all in Algeria.

However, beyond these apparent or real similarities, which may perhaps be regarded as testifying to the fact that the run-in contract formula does not involve a revolution in industrial relationships between enterprises in developed market economy countries and enterprises in developing countries, it is worth considering in some detail the new solutions which the run-in contract formula introduces in certain aspects of these relationships.[1/]

Two points which are found in all run-in contracts deserve to be noted. First, there is a guarantee given by the foreign contractor to the customer enterprise in the developing country regarding product quality and output. Secondly, there is a decision by the parties to organise and effect a transfer of technology.

In turnkey contracts, reflecting the traditional type of relationship between enterprises in industrialised countries and those in developing countries, the contractor generally guarantees the erection of the plant and not product quality or output. In the turnkey contract, the contractor's responsibility is thus discharged with the provisional acceptance of the plant.

In the run-in contract, on the other hand, it will be seen that the contractor's responsibility is prolonged by various means, and in particular by providing for a so-called initial management period.

In the turnkey contract, the transfer of technology, when provided for, is dealt with briefly or in a vague manner. It is treated more as an intention within the framework of the future development of relations between the contractor and the customer than as an immediate aspect of the terms of the contract considered.

1/ For a detailed study of these types of contracts, see the recently published work by Salem, M. and Sanson, M.A., Librairies Techniques, Paris, 1979.

In run-in contracts, on the other hand, the transfer of technology becomes a fundamental aspect of the relationship between the foreign enterprise and the local enterprise. In comparison with the turnkey contract, the run-in contract contains much more detailed legal provisions aimed at giving concrete form to the transfer of know-how to the customer enterprise.

Considering in broad terms the questions of the guarantee of product quality and output and the transfer of technology, we think that the main characteristics of the run-in contract can be taken into account.

1.1 The Contractor Guarantees Product Quality and Output

In actual fact, an attempt is sometimes made in turnkey contracts to provide for guarantees of product quality and output. From the point of view of the developing countries, however, such guarantees are problematic and ineffective. This type of guarantee has in practice hardly ever been implemented, for two reasons. The foreign contractor's guarantee is formulated in vague terms and in such a way that it is always possible to suggest that the customer is responsible or, at any rate, to throw doubt on the responsibility of the enterprise in the industrialised country.[1/]

When local courts rule that the foreign company is liable, proceedings to enforce its judgement in the territory where the company has its assets very often do not take place.[2/]

In this field, as has been clearly shown in certain critical studies on international commercial arbitration, the developed market-economy countries are reluctant to accept the competence of national courts in developing countries.[3/]

In any event, the general rule in turnkey contracts is that the contractor is responsible until the starting up of the plant - that is to say, until its provisional acceptance.

Between provisional acceptance and final acceptance, turnkey contracts provide for a form of contractor liability generally expressed in a clause of the following type: "The contractor guarantees the equipment against defects resulting from faulty design, faulty assembly or a manufacturing deficiency." It is difficult to give effect to this liability, however, inter alia because it is the enterprise in the developing country which has to operate the plant from the time of provisional acceptance. This means that it is always possible for the foreign contractor to plead that the poor quality of the product or the poor performance of the plant is due to faulty operation, organisation or maintenance - at any rate, that it is the developing country's fault.

1/ Cf. Salem and Sanson, op.cit., p. 120 et seq. See also below, examples of common guarantee provisions in turnkey contracts.

2/ Cf. Issad, M., Les techniques juridiques dans les accords de développement économique, in Droit international et développement, Office des Publications Universitaires (OPU), Algiers, 1978, p. 179 et seq.

3/ It is possible to argue that the run-in contract formula is not something invented by the developing countries.

It can thus be noted that, in this debate, the foreign contractor seems to base his argument for the responsibility of the customer on the latter's involvement from the stage of provisional acceptance. In other words, the foreign contractor is suggesting that, if he is to remain liable, close relations must be maintained with him and he should even be given authority over organisation and management. These are precisely the principles underlying run-in contracts.

In exchange for a prolongation of his guarantee over product quality and output, the foreign contractor naturally obtains additional remuneration, but also, above all, a prolongation of his dominant and active position in his relationships with the customer.

This guarantee on the part of the contractor affects various stages of the plant's construction and of production. It extends from the design of the plant to tis direction and to production volumes of the quality specified in the contract. This guarantee is often formulated as follows: "The contractor expressly guarantees the performance of his task. This guarantee covers the design and erection of the plant and the work and services relating thereto, whether in respect of installation or the organisation and operation of the plant."

In run-in contracts, there is even a general tendency to make the responsibility of the foreign contractor continue even though the customer enterprise in the developing country plays a certain role. Thus it is not unusual to find the following kind of provision in these contracts: "The participation of the enterprise (i.e. the enterprise in the developing country) in the erection and operation of the plant in accordance with this contract shall not have the effect of diminishing the responsibility of the contractor with regard to it, except as provided for in this contract."

Thus the run-in contract seems to be an advance on the turnkey contract in one respect, in that it seems to permit the intervention of the local enterprise without removing the liability of the foreign contractor.

However, it must be taken into account that the local customer enterprise has a purely advisory role. In addition, its know-how and stage of development do not usually allow it to play an active part in the design of the buildings, the disposition of the units and the installation of the production equipment.

In general, meanwhile, it is to be noted that the foreign contractor's guarantee is not of unlimited duration. Although its period of validity varies from contract to contract, it oscillates between 10 and 20 years. Within a single contract, the guarantee period varies depending on the nature of the work considered (for example, a ten-year guarantee for civil engineering works, a one-year or two-year guarantee for installation of the production material, etc.).[1/]

1/ The contract usually enunciates the general principles concerning the contractor's guarantee and then sets forth the technological guarantee (level and adequacy of the technology employed), the guarantee of the works (infrastructure), and guarantees concerning production equipment, schedules and performance.

This guarantee usually involves a precise obligation to repair or replace the defective part and sometimes provides for a financial indemnity with a ceiling fixed.[1/]

This guarantee relates to the design of the building or plant, to their erection and to production quality and output.

Thus, unlike in the case of turnkey contracts, provisions may be found in run-in contracts to the effect that "the contractor recognises that the obligations assumed by him under this contract are not only obligations to provide means but also obligations to achieve results", which means that, if his obligation if not fulfilled, it is difficult for the contractor to escape responsibility.[2/]

Run-in contracts generally include several articles concerning the responsibility of the contractor to comply with stipulations regarding production quantities and programmes and the specific requirements set forth in the contract.

Production quantities and programmes are generally given either in the contract or in annexes to the contract, and the product quantities used are the quantities manufactured by the contractor in his own plants. In this regard, one can cite a whole series of provisions in run-in contracts such as the following: "The contractor guarantees that the infrastructure work and the construction work on the plant will be carried out in accordance with established methods and the provisions and specifications of this contract and its annexes, and that they will be free from any defect and in conformity with the plans and drawings as communicated"; "The contractor guarantees that he will do all in his power to perform or cause the performance of all his contractual obligations..."; "The contractor guarantees the performances with regard to capacity and quality provided for" in the contract and its annexes.

In line with these guarantees, run-in contracts provide for a so-called initial management period which is not provided for in the traditional turnkey contract. This initial management period is of varying duration.[3/]

1/ For example, during a guarantee period set at one year from the provisional acceptance of the works concerned, the contractor remains responsible for the works constructed by him and is to make the necessary repairs. Or alternatively: the contractor is to replace defective components (production equipment) during a period of one year after the provisional acceptance of the plant. There are also penalties for delays, the amount of which can be fixed in relation to the cost of the contract or of a section of the plant (penalties ranging from 0.02 to 0.05 per cent per week of delay - see also Salem and Sanson in Les contrats 'clés en main' et les contrats 'produits en main'. Provisions also exist for compensatory damages equal to 2-5 per cent of the cost of the contract if the product quality and output specified cannot be attained.

2/ See Gross, B., La notion d'obligation de garantie dans le droit des contrats, Librairie Générale de Droit et de Jurisprudence (LGDJ), Paris, 1963.

See also Salem and Sanson, op.cit., p. 119.

3/ In the contracts that we have studied, the initial management period varies from a few months to one or two years or more.

The content and duration of initial management may show some variations from one contract to another, but in a general way what is involved is a prolongation of the period during which the foreign contractor is in charge of organising the plant and managing its production operations so that the programme provided can be attained under the conditions stipulated with the Algerian personnel trained for the purpose.

Several stipulations are generally contained in the provisions governing the initial management of the plant. The contracts indicate that this period is to "enable the contractor to accomplish his task". For this purpose, the customer in the developing country "entrusts" to him until final acceptance, until normal production is reached or until a date fixed by common agreement "decisions concerning normal daily operations at the technical management level". Within this context, the contractor manages certain services and "enjoys all the authority necessary to take the measures required in the normal exercise of his functions".

In these circumstances, it should clearly be difficult for the foreign contractor to escape his responsibilities regarding production. Considered in this way, the initial management arrangement thus conceived, in the eyes of the customer in the developing country, remedies one of the inadequacies noted in the relationship established by the turnkey contract which, as has been said, does not allow the contractor's liability during the production stage to be established.

Initial management also enables the customer to be shown that the plant, as designed, constructed or organised, is capable of attaining the stipulated production programmes and qualities with its Algerian personnel.

We obviously have here a reaction arising out of unfortunate experience with turnkey plants, which are known to operate sometimes at 10-20 per cent of capacity or sometimes not to operate at all.[1/]

The initial management arrangement also has the advantage of testing, under the contractor's supervision, whether the level of training of the Algerian personnel who are to take over from the foreign staff is adequate.

Undoubtedly, this type of relationship distinguished the run-in contract very clearly from the turnkey contract in so far as, apparently at least, the foreign supplier company envisages its own disappearance without production capacity and product quality being adversely affected. This concept seems in line with the demands formulated by the Group of 77 within UNCTAD and UNIDO, for example.

However, a number of reservations may be expressed regarding the initial management approach adopted in run-in contracts.

1/ As Judet and Perrin, op.cit., say, it would be interesting to draw up an inventory of turnkey plants which have failed to operate.

First of all, it seems undeniable that the period of initial management prolongs the period during which the enterprise in the developing country plays the role of a sleeping partner, whereas the best way of learning the skills of an industrialist is often to have to practise them as rapidly as possible. Furthermore, there is no certainty that, if the plant attains the performance levels specified during the initial management period, it will necessarily attain them or maintain them after that period.

In addition, the contractor is responsible for failure to attain the performances laid down only if a number of conditions are met (for example, no strikes, no personnel disputes, no breakdown in water or power supply, no interruption in supplies of materials). At the same time, in situations of force majeure the contractor may, if justified, claim extra time for compliance with his obligations.[1/]

Moreover, contrary to what one might gather from a rapid reading, not every run-in contract brings about a complete transfer of know-how and technology for all the plants' products. The result of this is that the co-operation or assistance of the contractor will remain necessary long after the initial management period.

Lastly, although it is easier, during the initial management period, to make the contractor answerable in the event of deficiencies, the injury that may be suffered by the client as the result of these deficiencies may not be fully covered by the penalties provided for in run-in contracts, in view of the ceilings fixed.

1.2 The Transfer of Technology and Know-How

Generally speaking, the transfer of know-how, which is always the subject of numerous provisions in run-in contracts, comprises several aspects which deserve to be reviewed. Run-in contracts generally distinguish between the transmission of know-how, vocational training and long-term technical assistance.[2/]

Whereas in turnkey contracts these problems are not seriously considered, particular attention is paid to them in run-in contracts.

1.2.1 Transmission of Know-How in Run-In Contracts

The transmission of know-how is not treated in the same way in all run-in contracts.

In some contracts, including the most recent contracts, transfers relate to industrial property, rights and know-how in respect of almost all the products and components to be manufactured by the plant, with regard not only to design, manufacture and utilisation but also to sale and maintenance.

1/ The most frequent situations of force majeure cited are war, strikes, epidemics, earthquakes, natural disasters, etc. "for the fulfilment of obligations affected by force majeure or analogous situations, an additional period of time shall be allowed equivalent to the delay resulting from this situation..."

2/ Among the many works on this subject, see Michalet, C.A., Le Capitalisme Mondial, PUF, 1976, particularly pp. 184-207.

In this type of transfer of knowledge, which is naturally the type preferred by the developing countries, the restrictive practices typical of multinational corporations are reduced to a minimum, or eliminated, at least under the terms of the contract.

Thus one finds in a run-in contract signed by a European company and an Algerian enterprise the provision that "the contractor transfers to the Algerian customer, in Algeria, without any restrictions, all industrial property rights and know-how concerning the design, manufacture, utilisation, sale or maintenance of the products of the plant (or products intended for the plant), including any changes and developments introduced in these products."

With this formulation, the only restriction relates to the territories for which the rights are transferred. Approached in this way, transfer of technology really deserves its name, at least at the theoretical level. The contract contemplates a genuine transfer which will permit the enterprise in the developing country to assimilate and reproduce the techniques and technology concerned.

Thus the developing country, doubtless at the cost of high fees, can initiate a process in the direction of technological independence, which is essential for economic independence. When it takes this form, without any restrictions in other provisions of the contract, it seems possible to regard the run-in contract as a factor promoting technological capability in the developing countries. It is even an improvement on the proposals made by the Group B countries in the framework of the Conference on an International Code of Conduct on Transfer of Technology held under the auspices of the United Nations Conference on Trade and Development.[1/]

As a result, this type of transfer rightly gives rise to great hopes on the part of the developing countries. But it must be realised that it is not necessarily easy for these hopes to be fulfilled.

First of all, an attentive reading of even the most promising contracts reveals that not all the parts necessary to a particular apparatus are produced in the plant which is the subject of the contract.[2/] It follows that, in respect of these components which are not produced by the plant, there is no transfer of know-how. In other words, if one considers the apparatus as a whole, as it is bought by the consumer, the transfer of technology remains partial.

This naturally means that, in the most favourable case, the developing country continues to be dependent on the enterprise in the industrialised country. This being so, the process in the direction of technological independence may be halted if situations develop in which the contractor with the know-how no longer sees sufficient advantage in co-operating.

1/ See in this connection the deliberations of the technology transfer and development conference, and particularly the paper by Touscoz, J., Librairies Techniques, Paris 1977.

2/ In the contracts studied, 15 to 30 per cent of the components are not produced in the plant constructed, and will therefore be imported.

In addition, even in a favourable situation where the transfer of technology is provided for in a very extensive form in the contract, it must be borne in mind that the purchase of industrial property rights and know-how by the developing country does not mean that the enterprise in this country is capable of assimilating the knowledge purchased and reproduce it. In these circumstances, the transfer of technology effectively takes place only when the customer enterprise in the developing country already has a minimum level of technological know-how and capability. In other words, the external input can only be incorporated in the fabric of domestic industry when internal forces are adequate to receive and assimilate it.[1/]

In other run-in contracts, many restrictions are attached to the transfer of know-how. In such cases, the rights and know-how transferred relate primarily not to the design of the machine but to its functioning. What is involved is a transfer of knowledge regarding the utilisation of the machine and not a transfer leading to complete mastery of the process or allowing the reproduction of the machine.

In these cases, the contracts provide that "The contractor undertakes to communicate his know-how relating to the organisation and management of the plant and the production of the articles enumerated in the contract."

The know-how concerning the production equipment relates to adjustment and maintenance and, in general, the operating conditions.

Irrespective of the foregoing, run-in contracts treat vocational training as a basic tool in the transfer of know-how.

1.2.2 Vocational Training and Run-In Contracts

Vocational training always constitutes a detailed chapter of run-in contracts. It thus appears as one of the criteria for distinguishing between run-in contracts and turnkey contracts, which do not usually include vocational training.

Generally speaking, the organisation of a policy for selection and training seems to be indispensable not only for an effective transfer of know-how but also in order to avoid sutting down a plant after the departure of the contractor's technicians and supervisory staff.

Vocational training and selection are organised by the foreign contractor, in parallel with the construction of the plant. The customer enterprise in the developing country does, however, intervene in the pre-selection phase by recruiting candidates for selection.

1/ See, Le Transfert de Technologie, Revue Tiers-Monde, January/March 1978.

Thus one of the most common formulations stipulates "that the contractor shall undertake to carry out the selection, theoretical and practical training and assignment to posts of the plant personnel, in keeping with the purposes of the contract". The contractor's powers in this field are very extensive. He determines the number of staff to be trained, carries out the selection by means of tests, and decides on the tempo, place and duration of training. The contractor also defines the jobs and the training programmes.

In certain contracts, the contractor undertakes to set up a training service and a training workshop in the plant or attached to the customer enterprise, in parallel with vocational training.[1/]

Generally speaking, the parties declare their determination to organise vocational training that will take into account not only production techniques and the operation of the plant but also local conditions.

These efforts are clearly important. Under the provisions of run-in contracts, vocational training seems to be designed to make it possible to train the necessary number of staff with the required qualities at the appropriate time, so that the plant can function with the personnel trained. Vocational training therefore pursues not only a functional objective but also the objective of independence with regard to staffing.

In reality, it is clearly difficult to achieve this aim, and practical experience of run-in contracts shows us some of the difficulties.[2/]

The first difficulty is related to the intervention of the customer, who, under the terms of the contract, must submit to the contractor the names of candidates from whom the latter must make a selection. It may then happen that the contractor considers that, taking into account the basic level of the candidates submitted by the customer, it is not possible to select a sufficient number of persons for training. This question may have very considerable consequences if the contractor tries in this way to abdicate his responsibility regarding the quality and quantity of the staff trained. That may mean that the customer must relinquish the hope that his staff will take over from the foreign technicians and supervisory staff in optimum production and operational conditions. In the discussion between the customer and the contractor, the latter tries from the very beginning to justify in advance any possible setback or lack of efficiency with regard to the transfer of technology. But it seems also possible to state that the existence of this problem must prompt enterprises in developing countries to adopt the run-in contract formula only when conditions genuinely allow them to benefit from the inherent advantages of the formula.

1/ Cf. Delye, P., Rôle des actions de formation dans les transferts techniques, Report to the Conference of Licensing Executive Societies, Paris, 14-15 June 1976.

2/ Cf., Congrès des économistes du Tiers-Monde; paper by Yachir, F. and Ait El-Hadj, S., Problèmes technologiques dans le Tiers-Monde.

Another problem springs from the difficulty of adaptation on the part of staff trained abroad to the ordinary conditions of work in the developing country. There are marked differences in the technical, social and professional environment.[1]

Run-in contracts are evasive or silent[2] on this point, whereas it seems that questions of interference between the organisation of enterprises, social legislation and the technology employed must be taken into consideration. In the same way, run-in contracts pass in silence over another difficulty related to the training of staff abroad, namely that related to the "brain drain". It certainly seems clear that the contractor cannot recruit on his own account the staff that he trains for the customer, but it seems difficult to verify the actual facts if the eventuality arises, in view of the nature of relations between the companies in one and the same multinational group, in particular by reason of their legal independence and geographical dispersion. In any way, the contractor could not prevent the recruitment by other competing foreign companies of staff trained for the customer. From this point of view, the all-around training that is so necessary and so much desired by the customer may turn against him.

1.2.3 Long-Term Technical Assistance

Run-in contracts usually provide for long-term technical assistance. The contractor undertakes to provide the spare parts not produced by the plant, to transmit new know-how, and to give further training to personnel already trained. Generally speaking, such technical assistance must be requested by the customer. Some technical assistance services are provided "free" by the contractor; others must be negotiated, particularly as regards price, in due course.

There is often general provision for long-term technical assistance in terms that confirm the commitment of the contractor to remain at the disposal of the customer to help him in his production, organisational and sometimes sales activities.

From the contractor's point of view, it is a question of opening doors for the maintenance and development of such activities with the customer. From the customer's point of view, it is a question of protecting himself against risks that he has not foreseen or against breakdowns in the supply of spare parts, or against the faulty assimilation of know-how, or else of adapting the plant to other activities.[3]

1/ Cf. Kahn, P., Transferts de technologie et division internationale du travail ..., in Droit international et développement, OPU, Algiers, 1978.

2/ Cf. Judet et Perrin, Du contrat 'clé en main' au contrat 'produit en main'.

3/ Long-term technical assistance may also mean that, despite the transfer of technology, the customer cannot do without the help of the contractor; that is a sign of dependence.

1.3 Conclusion

Two types of approach may be adopted for assessing run-in contracts:

The first approach is based on the hypothesis that wide-ranging and intensive co-operation with the foreign enterprise that possesses the technology is necessary for the developing countries. It is assumed that these technologies, which are closely linked to the development of the countries of origin, will necessarily be development factors in the developing countries. On these assumptions, run-in contracts would be assessed without questioning either the system of relations that forms their context or the development plan of the recipient country.

According to this hypothesis one can only, at most, propose some piecemeal improvements to run-in contracts.

1. It would in fact be profitable for the customer enterprise in the developing country to participate as far as possible in the work on the basic concept and establishment of the plant, in the various stages of design and construction work. The run-in contract makes an effort in this direction which should be developed and intensified so that, in contra-distinction to present practice, the customer would not be content to play the role of a mere provider of administrative authorisation.[1/]

Some studies and work should be undertaken by the customer enterprise, under the direction of the contractor, if necessary.

2. Local enterprises must not be placed on the same footing as foreign enterprises but must receive preference with regard to time-tables and prices.[2/]

3. The raw materials and products available in the market of the developing country must be given preference. In any case, the customer must play an active part in seeking out his own raw materials or products.

4. Some run-in contracts do not make clear what law is applicable and what are the competent courts. The law of the recipient country must apply if it is not wished to develop practices that would hinder the implementation of the economic development plan. If national legislation is not applied, the legislation according to which the plan is implemented will be without effect on the activity that is the subject of the run-in contract.

5. The penalties provided for against the contractor are always inadequate. It would be valuable to lay down penalties that would ensure that all of the damage caused would be repaired. In any case, it is not desirable to set ceilings so low that the contractor may prefer to suffer the penalties rather than carry out the investment stipulated.

1/ Cf. various papers in Transfert de technologie et développement, CNRS Librairie Technique, Paris, 1977.

2/ In this case, time-table and prices fixed in the contract must clearly be studied in that light, without, however, doing away with the guarantees provided by the contractor.

5. The price for the transfer of know-how and technical assistance is often difficult to assess. In some contracts the relevant price is evaluated separately from other prices, but in other contracts more comprehensive assessments are made. The price for the transfer of know-how, vocational training and technical assistance must be specified in detail and calculated separately, and the relevant amounts should correspond to the transfer actually effected. Know-how that has become public property must not be sold. It must be possible for the customer to make wide use of, and to resell, know-how that he has purchased.

The second type of approach does not systematically accept the necessity of looking abroad in order to construct the economy of a developing country. In this case it is believed that, in order to break out of underdevelopment, the doctrine of individual and collective self-reliance must be adopted. It is thus necessary to rely first of all on one's own resources.1/

Under this hypothesis, the following remarks may be more regarding run-in contracts:

1. This type of contract should be used only when the country lacks the strength and factors that would enable it to dispense with the intervention of the foreign enterprise.

2. The types of technology adopted under the contract must conform to the technologies selected by the development plan.

3. The run-in contract can be valuable for development only if:

(a) The economic development plan is itself the expression of the needs of the great majority of the population;

(b) The enterprise and the national economy are at a level and in a condition that would make it possible to assimilate the technologies and know-how transferred.

4. With those assumptions, all the remarks made with regard to the first hypothesis then apply.

However, study of the stipulations of run-in contracts must be supplemented by an analysis of the manner in which disputes between the contracting parties are settled, in order to have a comprehensive view of the relationships between the transnational enterprises and the enterprises in the developing countries.

1/ See Benchikh, M., Souveraineté, développement et perspectives du nouvel ordre international, in Droit international et développement, OPU, Algiers, 1978.

CHAPTER ..: ARBITRATION

Since the accession to sovereignty of almost all the territories formerly under colonial domination, investment contracts in the developing countries, particularly the most important contracts, have provided for arbitration procedure and have thus set aside the competence of the national courts in the developing countries for the settlement of disputes arising out of the implementation or interpretation of contracts.

The development of the practice of having recourse to arbitration is obviously not fortuitous. It is connected very closely with a historical period of relationships between the industrialised and the developing countries. During the colonial period, arbitration was not very widespread, for several reasons: either the investments of the colonial Power generally fell within the jurisdiction of the metropolitan courts or else the colonial Power in any case controlled local law and jurisdiction. In certain cases, finally, when the local courts and local law had some autonomy, the colonial Power used force, either by replacing indigenous politicians or by other means.

In all cases it is clear that, until the 1950s, foreign investors had no cause for fear regarding the maintenance of the privileges enshrined in contracts or regarding the stability of such contracts. The developing states had only formal sovereignty. They therefore did not intervene in operations regarding foreign investments in their territories. Even after they gained their sovereignty, most states, with a few exceptions, were content to levy customs duties, some royalties or some taxes.

But when internal struggles in the developing countries impelled the authorities of the state to demand greater powers of intervention, and the investment capacity and needs of foreign, particularly American, enterprises were confirmed, breakdowns or crises resulted between the developing countries and their former colonizers.

Consequently, the economic relations of the developing countries became somewhat diversified, which was reflected at the same time in an intensification of relations with the Western economies dominated by the American transnational enterprises.

That was the context in which developed a number of arbitration formulae aimed at solving disputes regarding investments of transnational corporations in the developing countries. In this connection one might mention the Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted by the United Nations Conference on International Commercial Arbitration on 10 June 1958, the European Convention on International Commercial Arbitration signed at Geneva on 21 April 1961, the regulations of the Court of Arbitration of the International Chamber of Commerce applicable since 1 June 1975, the World Bank Convention of 18 March 1965 and the Arbitration Rules of the United Nations Commission on International Trade Law, adopted by the United Nations General Assembly on 15 December 1976.

In fact, these texts are only the best known among several dozen of this kind such as the arbitration rules of the American Arbitration Association or of the Japan Commercial Arbitration Association. Even some United Nations regional economic commissions have prepared commercial arbitration regulations.

Some intergovernmental bilateral or multilateral agreements organise arbitration procedures in respect of investments by enterprises from the developed parties in the territories of the developing parties. This is the case, for example, with the Franco-Algerian agreement of 29 July 1965.[1/]

To sum up, the adoption of an arbitration procedure has become standard practice in contracts between multinational enterprises and enterprises in the developing countries.[2/]

However, despite the diversity of the texts and their legal nature, these various arbitration formulae have very many features in common. In the relations between the transnational enterprises and the developing countries, the aim of arbitration is always to exclude the competence of national courts, to consolidate the privileges and benefits obtained in the contract by the foreign companies and to place the economic activity organised under the contract more or less outside the national economy.

2.1 Exclusion of the Competence of Local Courts

The principles governing the organisation and practice of arbitration between transnational enterprises and the developing countries are in fact generally uniform. In the ultimate analysis, the point at issue is to establish an *ad hoc* arbitration court or to apply to a body that is independent of the parties and will act as an arbitrator in such a way that local courts are partially or totally excluded. Usually, therefore, the following pattern is found: the foreign enterprise and the developing country (or the local enterprise) each designate an arbitrator and these two arbitrators, by common agreement, appoint a third arbitrator to act as president. According to the arbitration formula chosen, a variety of authorities (International Chamber of Commerce, Stockholm Chamber of Commerce, the President of the International Court of Justice, the Chairman of the Administrative Council of the International Centre for the Settlement of Investment Disputes of IBRD, etc.) appoint the arbitrator for the party in default or the arbitrator to act as president.

Thus, as an example, the IBRD Convention on the Settlement of Investment Disputes between States and Nationals of Other States provides in article 37 that:

1/ The Franco-Algerian agreement regarding hydrocarbons and industrial development of 29 July 1965 is modelled, with some alterations, on the arbitration system provided for under the Evian Agreements of March 1962. For a discussion of these problems and, particularly, for examples of arbitration awards, cf. Benchikh, M., Les instruments juridiques de la politique algérienne des hydrocarbures, LGDJ, Paris, 1973; see in particular, Affaire TRAPAL, pp. 68-73, and the arbitration award pp. 114-132.

2/ The adoption of arbitration in contracts between transnational enterprises and developing countries (or enterprises in them) does not mean that the developing countries are in favour of arbitration. They submit to this demand of the transnational enterprises which make arbitration the condition *sine qua non* of investment.

"... The tribunal shall consist of a sole arbitrator or any uneven number of arbitrators appointed as the parties shall agree.

"Where the parties do not agree upon the number of arbitrators and the method of their **appointment**, the Tribunal shall consist of three arbitrators, one arbitrator appointed by each party and the third, who shall be the president of the Tribunal, appointed by agreement of the parties."

Article 38 continues:

"If the Tribunal shall not have been constituted within 90 days after notice of registration of the request has been dispatched by the Secretary-General in accordance with paragraph (3) of Article 36, or such other period as the parties may agree, the Chairman shall, at the request of either party and after consulting both parties as far as possible, appoint the arbitrator or arbitrators not yet appointed."

With very slight differences, this is the same system as that of the International Chamber of Commerce, the UNCITRAL Arbitration Rules and many other conventions.[1/]

In this field, the various arbitration formulae differ in respect of the authority responsible for the appointment of the arbitrators, the lists of arbitrators and the time limits for the constitution of the Tribunal. However, the essential problem that is immediately raised by having recourse to a tribunal lies rather in the exclusion of the competence of courts in the developing countries in which the investment takes place. That is without doubt the reason why many developing countries still have misgivings with regard to arbitration, despite the variety of formulae proposed to them. From this point of view, which is incidentally that of all the forces which seek to construct an independent economy in the developing countries, the principal problem is the re-establishment of the competence of national courts. In fact, excluding the competence of the national courts seems to the developing countries to be an infringement of their sovereignty. This viewpoint is far from a mere attitude of mind, and the arguments of the transnational enterprises and their lawyers are in fact extremely weak.[2/]

First of all, and rightly, the developing countries themselves consider the competence of their national courts with regard to all activities organised on the national territory to be a prerogative that stems from their sovereignty.

1/ Algerian enterprises often have recourse to arbitration by ICC. The venue of the Tribunal varies; it is usually in Europe, particularly in Switzerland, but sometimes in Algiers. Cf. Issad, M., Les techniques juridiques dans les accords de développement économique, in Droit international et développement, OPU, Algiers, 1978, pp. 193-194.

2/ Cf. on this subject, Benchikh, M., Les instruments juridiques de la politique algérienne des hydrocarbures, op.cit.
With regard to the point of view of Western doctrine, see the following selection from the abundant literature on the subject: Amadio, M., Le contentieux international de l'investissement privé et la convention de la Banque Mondiale du 18 Mars 1965, University of Toulouse, 1967. Carabiber, C., L'arbitrage international de droit privé, LGDJ, Paris, 1960. Fouchard, P., L'arbitrage commercial international, Paris, Dalloz, 1965. Lalive, Un grand arbitrage pétrolier ..., Journal du droit international, 1977.

Such competence is in fact closely linked also to the right of each state to free self-determination in fixing the laws of its development, relevant structures and sanctions.

Several arguments are nevertheless advanced by the transnational enterprises to exclude the competence of the national courts in the developing countries.

2.1.1 Appropriate Local Courts Do Not Exist or, If They Do, They Have Little Experience

These arguments, which are advanced mainly in relation to countries that have just acceded to independence, do not seem pertinent. In fact, provisional national courts are established immediately after the accession to sovereignty, usually, one might add, with the co-operation of the former colonial Power and in most cases with the co-operation of the western developed countries. Incidentally, states that are not yet completely independent do not launch large-scale development operations and in any case it is generally not during that period that transnational enterprises, with the possible exception of those of the former colonial Power, attempt to carry out investments there.

However that may be, if the genuine reason for the exclusion of the competence of local courts is the fact that there are none, the contract should provide that the arbitration court should have only provisional competence, which is not the case.

The same may apply in the case of local courts without great experience, although in this respect it seems difficult, without disregarding the sovereignty of the state, to assess at what point the national courts will have gained sufficient experience.

How, for example, could it be denied that the courts in the developed market economy countries have little experience of disputes regarding planned investments? Moreover, the arbitrators, who are generally well-known professors of law, have no particular experience of the struggle against under-development, which is the context of "development contracts", as their name implies.

2.1.2 The Judges in the Developing Countries Are Not Sufficiently Independent of the State

The transnational corporations have often stated that the judges in the developing countries are too much under the influence of the state apparatus to be able to arrive at independent judgements in disputes involving the enterprises or the state in their countries. Though there may be no such thing as independense per se, the criterion of independence is evidently that adopted in this context in the industrialised countries in which these corporations were originally established.

On this point, it would be very interesting to place the matter on a theoretical level and to adopt a historical approach that would show that the jurisdictional apparatus of the countries that are now developed was for a long time practically identical with the state apparatus, that, even in the developed market economy countries, the state apparatus

includes the jurisdictional apparatus, whatever the apparent "independence" of the latter, or even that the jurisdictional apparatus in any case operates within the framework of the dominant ideology of the state. But experience shows that a discussion with the transnational enterprises or their lawyers at this theoretical level is practically impossible.

It is therefore necessary to examine the criteria regarding the independence of judges in a more practical manner. It seems that it is the constitutions (or the constitutional systems) of the industrialised countries, like those of the developing countries themselves, that determine the structures and fields of competence of state jurisdiction. Judges are generally appointed by the state and everywhere they have to apply the laws promulgated by the organs of the state. The result is that there is a very wide gap between the affirmed principle of the independence of judges and the day-to-day realities of jurisdiction. Furthermore, who can tell how many judges have been transferred to other posts, punished or forced to resign in the industrialised countries, as in the developing countries, because they did not take heed of their dependence on government?

The fact is that the transnational enterprises have no confidence in [illegible] courts of the developing countries, whatever the independence of their judges, because, as will be seen, a national court has the tendency to "introvert"[1/] the effects of the activity on which it is to pass judgement, whereas an international court, which necessarily sees the matter from the outside, tends to "extrovert"[2/] the effects of the activity on which it is to pass judgement, whatever its bona fides, which is not being called in question.

In fact, if it were only a question of judges' independence from the state, it could be conceived that arbitration courts composed solely of nationals of the developing countries who were competent and independent of the state (professors, barristers and experts) could be set up to consider disputes regarding investments of the transnational corporations.

Study of the composition of arbitral tribunals shows on the contrary that lawyers from developing countries very seldom serve on them and that "the president of the tribunal" is never a national of a developing country.[3/] The exclusion of local courts and the appointment of arbitrators recruited from the capitalist development system or the fact that the president of the tribunal invariably comes from a market economy country thus lead to the crystallisation of a trend which makes it impossible to take into effective consideration a socialist economic development system or even a system of self-reliant development.

1/ "Introvert" is used here to mean to evaluate the contract and its consequences in the light of the needs of the country and its economic and legal system.

2/ "Extrovert" is taken here in the sense that the judge takes into consideration needs and standards external to the developing country.

3/ Cf. Fouchard, P., Arbitrage et droit international du développement, in Droit international et développement, OPU, Algiers, 1978.
P. Fourchard seems to favour a considerable presence of Third World lawyers in arbitration tribunals.

Excluding the competence of national courts, which is the result of arbitration, is therefore not an infringement of the exercise of abstract sovereignty. Very definite economic concepts and interests are at stake.

Since the parties are allowed to choose their arbitrators, it is claimed that a balance is struck between the conflicting interests. In reality, the system operates, as will be seen, to protect the privileges and benefits that are enshrined in the contract in favour of the party that has had the power to adopt a dominant position or has found a way of adopting one. Analysis of investment contracts between developing countries or their enterprises and transnational corporations shows that the latter hold a dominant position. "Thus, run-in contracts, as has been seen, do not decisively change this situation to the advantage of the developing countries."[1/]

2.2 Arbitration as an Instrument for Safeguarding the Privileges of Transnational Corporations

Arbitration is always presented as an institution designed to guarantee the equilibrium assumed to be established by the provisions of the contract. Arbitration is based on the notion of the equality of the contracting parties, who can use this procedure to protect their interests as defined by the contract. Arbitration is considered to be at the service of both parties equally. Unfortunately, this assumption is not borne out in practice.

It is well known that the investment contracts concluded by foreign companies in developing countries bring together a constructor or an operator who is generally the only agent active on the spot, and a developing country (and/or its enterprise) which supervises externally the establishment of an industry or the working of a deposit.

The result is that more often than not, when the government of the developing country realises that it is necessary to rectify, correct or halt the action of the manufacturer or foreign operator, it has, in the interests of the economy, to take emergency measures by invoking its public powers. The transnational corporation, feeling itself the injured party, then requests the establishment of an arbitral tribunal. In such cases, as can be illustrated by numerous examples of arbitration, the arbitration body presented in the documents setting it up as being at the service of both parties is in practice at the service of the transnational corporations.[2/]

The objection can of course be raised that the developing country should have resorted to arbitration before it became necessary to take emergency measures. This argument, however, does not take account of the true relationship between the two parties. In the great

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1/ Cf. Salem and Sanson, Les contrats 'clés en main' et les contrats 'produits en main', with particular reference to the unsuitability of arbitration for "turnkey" contracts, p. 101 et seq.

2/ It is extremely rare in Algeria, as elsewhere, for the arbitral tribunal to be set up at the initiative of the enterprise of the developing country.

majority of contracts of this type, whether they are contracts for the exploitation of petroleum minerals, turnkey contracts or run-in contracts, the developing country is not an active agent on the spot. It cannot itself cope with either the design, or the operational stage. It can therefore intervene only in cases of disaster. The result is, as shown by numerous examples, that arbitration is in reality used to block intervention by the developing country. The history of relations between transnational corporations and developing countries in the field of petroleum is a good illustration of the conditions under which recourse to arbitration takes place.

In Algeria, all arbitration proceedings relating to hydrocarbons have been initiated in order to suspend and annul action by the state or its enterprise.[1/]

But the action of the developing country has very little chance of being upheld by the arbitrators for the simple reason that the contracts of transnational corporations are generally "stabilised" during their period of validity. In other words, during this period the fiscal, economic and other legislation is always that in force at the time the contract is signed. These contracts considerably reduce the developing countries' power to intervene, with the result that the fiscal, financial and tariff guarantees and privileges acquired are very difficult to change. On these many points, the contracts depart from common law and impair the state's power of intervention (cf. the investment codes of all developing countries).

If the state does intervene, the arbitrator can, by invoking the "legal security" clause provided in the contract, suspend the intervention before annulling it. Indeed, the texts governing arbitration sometimes provide that recourse to arbitration leads to the suspension of the measure which is the object of the complaint. The analysis of a large number of cases submitted to arbitration shows that from the case Sheikh of Abu Dhabi versus Petroleum Development Corporation to the case ARAMCO versus Saudi Arabia, or from the Saphir case (award of 15 March 1963) to the case TEXACO versus the Libyan Government, not forgetting the numerous cases submitted by petroleum companies against the Algerian Government, arbitration operates in favour of the transnational corporations by safeguarding their acquired advantages and inhibiting the public authorities' power of intervention.

Both turnkey and run-in contracts contain a series of provisions limiting the effects of fiscal, financial and customs law. They provide for various economic advantages of which the arbitrator becomes the ultimate guardian. But these deviations, offered by the investment codes of the developing countries and confirmed and enunciated in the contracts

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1/ Cf. Benchikh, M., Les instruments juridiques de la politique algérienne des hydrocarbures, LGDJ, Paris. For example, in the Zarzaitine case, the foreign company was working hydrocarbon deposits without observing the principles of sound conservation. When the Algerian administration realised this, it had to take emergency steps to correct the situation. Recourse to arbitration by the company had the effect of blocking the authorities' action. Likewise, in the fiscal field, the tax rectifications introduced by the administration to combat fraud by petroleum companies during the period 1965-1971 were very often blocked by recourse to arbitration.

concluded by transnational corporations in these countries, have in the eyes of the arbitrators a very important consequence. They serve as presumptive evidence of the will of the parties to denationalise the contract by applying to it the rules of foreign law, general principles of law, or rules derived from international trade practice, etc., even when the contract stipulates that the law applicable is that of the developing country. 1/

Thus, in the ARAMCO decision, the arbitral tribunal, after observing that "the law applicable to the concession is the law of Arabia", stated that "matters coming under private law are in principle subject to the law of Saudi Arabia, but with the important proviso that this law must where necessary be interpreted in the light of, or complemented by, the general principles of law, the practices followed in the petroleum industry and pure legal science, particularly when certain private rights which the concessionaire must enjoy if the concession is not to be robbed of its substance are not guaranteed to him in an indisputable manner by the law in force in Saudi Arabia".

In many agreements between transnational corporations and developing countries, the reference to foreign law, to general principles and to international trade practice is quite explicit. Now these rules and, specifically, commercial and industrial usage derive from a situation in which the dominant factor is the activity of transnational corporations. The practices followed in the petroleum industry are unquestionably those established by the transnational petroleum companies themselves. International trade usage is the result of practices designed to permit the expansion of large capitalist enterprises and having nothing to do with the development of the developing countries.

Thus, the frame of reference of arbitration is a system of social and other relationships forged by the history of capitalist development. It is therefore not surprising that it tends to perpetuate this situation by using it as a guideline and a basis for its decision.

Arbitration thus constitutes, in relations between the developing countries and transnational corporations, a framework conducive to maintaining and intensifying the extroversion and economic dislocation of the developing country.

2.3 Arbitration as an Instrument Promoting the Economic Dislocation and Extroversion of the Developing Countries

It would appear from the above discussion that, because arbitration excludes the competence of national jurisdictions, and bases itself largely on a system of foreign rules, it can hardly promote introversion of the economic effects of the contract.

1/ Cf. Issad, M., op.cit. Issad writes that, of the 17 contracts between foreign companies and Algerian enterprises that he examined, 11 stated that Algerian law was the law applicable. But, we feel, it has also to be understood that, even when reference is made to Algerian law, reference is made at the same time either to general principles of law or to commercial and industrial practice. These references are sufficient in the eyes of the arbitrators to annul or reduce the scope of local legislation.

Thus, it will be difficult for arbitration to consider the activity covered by the contract as an element in a national economy under construction.[1/]

A simple example: Many contracts between transnational enterprises and developing countries specify that the foreign company "shall give preference, wherever possible, to local raw materials and the services of local enterprises." The application of this clause is obviously important in order to spread the contract's investment benefits throughout the country's economy. In this connection, the contract arbitrator, in case of conflict, should, if he has a concern for the effect of the investment on economic development, minimise the significance of questions relating to delivery deadlines and the prices of local products and services. But from the point of view of capitalist commercial practices, on which arbitrators base their activities, deadlines and prices are essential factors, outweighing the long-term advantage which domestic industry would have derived from the use of its own products and services. From this point of view, the impossibility for the arbitrator to have an overall view of the country's economic development promotes a foreign investment practice that tends to isolate such investment from the rest of national economic and social life: this is a characteristic of a state of dislocation in a country's economy. Thus, the arbitrator will not consider the developing country's intervention regarding taxes or finance, supplies or the rate of production in terms of the need for self-reliant and increasingly independent economic development. The arbitrator's reference model is based on another type of development, conceived elsewhere than in the country in whose campaign against under-development the contract must play a part. From this point of view, even when the contract includes a few clauses concerning the application of national law, arbitration is an instrument guaranteeing extroversion of the investment by the transnational enterprise.

Even when the arbitrator recognises that a clause in the contract establishes the applicability of national law, reference to the general principles of law and practices and usages of commerce or industry makes it possible to prevent the true application of the laws of the developing country. Thus, even when the contract contains no guarantees or privileges, the arbitrator will deduce them from Western principles and usages. This is the method used by the arbitrators in the case Société européenne d'études et d'entreprises versus the Yugoslav Government in deciding that currency devaluation should not affect the company: "Considering that it was obviously the intention of the parties at the time of concluding the contract, to stipulate equivalent economic compensation, and further considering that, as the contract is an international one concluded without speculative intention, it can be assumed, as has been judged, that the parties wished to allow for a devaluation guarantee, barring an explicit agreement to the contrary, and that, in addition, it would be in violation of good faith for the Government of a State having ordered and received services to refuse to pay the true value and to wish to profit from the considerable devaluation of the currency of payment."

1/ It is essential that this factor should be taken into account, as the developing countries are constantly insisting in various forums. For example, the developing countries have stressed the need to place the study of every economic issue in the context of an overall view of the development process. See the records of the Sixth and Seventh Special Sessions of the United Nations General Assembly, 1974 and 1975. See also the Declaration and Plan of Action adopted at the Second General Conference of UNIDO (Lima), and the records of the fourth and fifth sessions of UNCTAD. In particular, see the Arusha Programme prepared by the Group of 77.

In other cases, the various clauses relating to the privileges obtained by the foreign company are such that the arbitrator can conclude that the existence of these clauses is incompatible with some legislative or regulatory action taken by the developing country. In a recent arbitration between the oil companies and the Libyan Government, the sole arbitrator went so far as to consider that these clauses rendered nationalisation irregular under the contract.[1/]

This award can be seen as a desperate effort on the part of the transnational enterprises to counter legislative and regulatory action by the developing countries, and the latest contribution of the arbitration institution towards stemming the tide of nationalisation.

For the sole arbitrator "national law (in this instance, the principles of Libyan law) can be raised to the level of international law. In other words, national law is incorporated into international law, as a body of substantive law, i.e. by reason of its normative content, and it then becomes a set of rules applicable by the international tribunal. Its applicability is based not on the automatic sovereignty of the contracting State, but on the common will of the parties. The national law of the contracting State is thus looked upon as lex contractus by incorporation." In fact the professor whom the sole arbitrator cites expresses this position better when he writes that "the presence in the contract of a stipulation referring to the national law of the host country does not therefore necessarily mean that internationalisation arises out of the other characteristics of the contract (and such is the case with most economic development agreements) the contract will still be internationalised, with national law applicable as reference law on the basis of the choice of the parties, as authorised by the international law applicable to contractual matters."

Thus, according to this award, which expands on what was contained in germ in other awards, the investments of transnational companies are not seen primarily in the national context of the host country despite the applicability of local law, but are elevated to the international level in such a way that they do not come under the sovereignty of the host country. The consequence for the arbitrators is obvious: "a developing country may not resort to nationalisation in order to annul the contract thus internationalised."

The arbitrator doubtless does not contest the right of each state to nationalise, but he considers that the contract which has been internationalised does not permit this right to be exercised.[2/]

1/ Arbitration award of 19 January in the case TEXACO/CALASIATIC versus the Government of Libya. See the text in the Journal du droit international, 1977, p. 350 et seq.

2/ The arbitrator considers that "the nationalising State may not ignore the commitments of the contracting State".

The arbitrator could have noted that the state did not waive its right to nationalise despite the stabilisation of the contract, that a waiver of this right cannot be assumed and that the reference to Libyan law strengthens the right of the state to resort to nationalisation.

If one considers that the existence of stabilised and "internationalised" contracts makes it illicit to resort to nationalisation, arbitration is virtually tantamount to prohibition of most nationalisations relating to foreign interests in developing countries, since these interests are always reflected in such contracts.

From the practice of nationalisation and its acceptance by all countries, including the industrialised capitalist countries, the arbitrator could have concluded that a common law rule had arisen according to which even when nationalisation takes place to terminate a stabilised contract, this nationalisation is licit. It was precisely this that the oil or industrial companies admitted some years after the accession to sovereignty of the former colonies.[1/] However, the arbitrator considers that this practice, which is favourable to nationalisation, is a simple fact "inspired by considerations of expediency", which should not influence law.

The arbitrator could also have used the resolutions of the United Nations General Assembly relating to sovereignty over natural resources to demonstrate that, although these resolutions do not always constitute legal obligations, they indicate the current trend in law and clarify the meaning of existing law. The arbitrator, on the contrary, points out that, when some industrialised capitalist countries are not in agreement with a resolution, it remains without legal force.

Lastly, the arbitrator could have considered that, since nationalisation is accepted by international law, it cannot violate the contractual legal order even if the latter is partially internationalised.

As it is designed and operates, arbitration between developing countries and transnational companies definitely appears to be an instrument in the service of the latter. It is closely linked with the protection of the advantages and privileges acquired under investment contracts by the foreign companies in developing countries. Thus, it operates as a legal instrument promoting the economic dislocation and extroversion of the developing country and so is a factor in the legal prolongation of economic dependence.

Only the exclusive application of national laws and competence of the ordinary legal organs of the host country constitutes a true solution in keeping with the principle of the sovereign equality of states, as developed in, and since the adoption of, the Charter of the United Nations.

1/ The United States or French companies nationalised in Algeria did not contest the nationalisation measures before an arbitral tribunal. The right to nationalise is recognised by all states as a principle of international law. Only indemnification is subject to discussion. See the three studies devoted to these matters by Feuer, G., Kamitatou, M. and Wodier, F. in Droit international et développement, op.cit.

Provisionally, it should be possible to replace international arbitral tribunals by arbitral tribunals composed of nationals selected from outside the central government administration and national corporations. One could even imagine that specialists from other countries might assist these tribunals in a consultative capacity. At the outset, these national arbitrators could be chosen on an ad hoc basis by each of the parties, but it would be preferable to organise national arbitral tribunals specialising in development matters. These specialists could be recruited by a nomination authority convened by the parties.

In this connection, UNIDO, as regards industrialisation, and other organisations of the United Nations system, each in its own field, could play an important and useful role. For example, the Executive Director of UNIDO could, where appropriate, be the nominating authority, and UNIDO could, in its field, perform the role played by the International Chamber of Commerce with regard to arbitration.

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INDUSTRIAL CO-OPERATION IN THE FIELD OF SMALL AND MEDIUM SCALE PRIVATE FOREIGN DIRECT INVESTMENT IN LOW-INCOME DEVELOPING COUNTRIES

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SUMMARY

In spite of the economic, social and political problems encountered with the activities of foreign companies in developing countries, it is generally agreed that Private Foreign Direct Investment (PFDI) is indispensable for rapid and equitable expansion of industrial production in the developing world. At present, however, the group of the low-income countries with per capita incomes below US $ 250 and an aggregate population of more than 1.2 billion has little chance to obtain significant amounts of PFDI. The large multinational corporations, which dominate international investment business, are neither appropriate for low-income developing countries, because of their sophisticated technology and large-scale production, nor inclined to invest in these countries, because the markets are too small. There is, therefore, an urgent need to mobilise small and medium-sized PFDI from the industrial countries and the semi-industrialised developing countries and to direct it to the low-income developing countries.

Although substantial latent interest exists in such investments among small producers in the more advanced countries, only few investments are actually made because the political and economic risks are considered too high. The host countries, on the other hand, still prefer large investors, because they think small investors offer less chance of achieving success.

The policy problem, therefore, is to reduce the risk on both sides, in order to make such investments mutually attractive and to assure a development-promoting performance. It can be solved through tripartite co-operation among the home governments, the host governments and a politically neutral international agency. Major elements of a corresponding policy package, as proposed here, are:

- comprehensive investment guarantees, including a guaranteed minimum rate of return, by home governments for approved projects of small producers;
- a thorough project evaluation, involving both governments and the international agency;
- performance guarantees by home governments for its investors;
- a special fund to back the investment guarantees for PFDI from semi-industrialised developing countries.

It is expected that the proposal's implementation will not only significantly increase incomes and employment in the host countries, but also support small companies, thereby preserving jobs in home countries. In the long run, debt relief and uncontrollable forms of aid can become obsolete. The proposal, therefore, is in the interest of all parties concerned and, as such, should be politically acceptable.

CHAPTER 1: INTRODUCTION

An important element of the New International Economic Order (NIEO) is the rapid expansion of industrialisation in the developing countries. The UNIDO conference held in Lima in March 1975 set the target for the share of Third World countries in world industrial production at 25% for the year 2000. There is general agreement that the attainment of this target requires close co-operation between developing and industrialised countries. In particular, it has been realised that Private Foreign Direct Investment (PFDI) has to play an important role in this co-operation, because it is one of the major mechanisms by which real capital, technologies and managerial know-how are transferred from the industrialised countries to the developing countries. PFDI benefits are accompanied by certain costs which not only imply an exploitation of the host country's human and physical resources but may also seriously impede the attainment of major development goals. The conclusion to be drawn from past experience is that policies are needed which, on the one hand, contain and enlarge the stream of benefits resulting from PFDI and on the other, minimise their social costs.

CHAPTER 2: TOWARD AN EQUITABLE EXPANSION OF INDUSTRY IN THE DEVELOPING WORLD

In the past, most PFDI went to a small group of semi-industrialised developing countries. This PFDI originated mainly from multinational corporations. Their tremendous power created economic and political problems. To cope with these problems, most of the major host countries developed control mechanisms and an impressive administrative capability to channel and control PFDI according to the country's development goals. The foreign corporations, on the other hand, have demonstrated substantial flexibility in adjusting to the demands of host countries. The important lesson that may be drawn from this experience is that developing countries can, indeed, derive substantial benefits from PFDI without incurring the high social costs observed in the past.

The industrialisation objective laid down in the Lima declaration can be reached only be expanding industrial production to all developing countries. However, the present trend of manufacturing PFDI strongly favours the semi-industrialised countries and almost entirely neglects the low-income countries. Without appropriate policies, it can be expected that industrialisation will accelerate in the former whereas the latter will lag behind. A polarisation may develop among developing countries similar to that now existing between developed and developing countries. To prevent such division, it is of utmost importance to identify the factors which have led to the heavy concentration of PFDI in the more advanced developing countries and to design policies which would give the hitherto neglected countries an equitable chance to obtain PFDI.

2.1 The Problem of Concentration

The factors causing the concentration are to be sought in the economic nature of prevailing manufacturing PFDI and the economic characteristics of the host countries. Traditionally, these PFDI are undertaken by large, mostly multinational corporations. Their technology and marketing are geared toward relatively large markets, which, outside the industrialised world, are found only in the more advanced developing countries. It follows, that the traditional manufacturing PFDI might neither find low-income countries attractive, because of market size, nor be appropriate for these countries.

The more recent species of export-processing PFDI is quantitatively much less important. Most of these investments come also from multinational corporations which reduce their production costs by farming out labour-intensive production to low-wage countries. Here again, a concentration is visible in more advanced developing countries with disciplined and skilled labour force.

2.2 The Type of PFDI Needed for Low-Income Countries

Much more suitable for the economic conditions of low-income developing countries are investments from smaller and medium-sized companies. The reasons can be roughly sketched as follows:

- Smaller companies are used to produce efficiently at competitive costs for relatively small markets, such as those existing in low-income countries.
- Their technologies are less capital-intensive, therefore employing more labour; and their production and marketing process is administratively less sophisticated, therefore requiring lower organisational and managerial skills.
- The lower capital and skill intensities facilitate the training of local personnel, the control of the operation by host country government institutions, integration into the domestic economy and, later on, a transfer of ownership and management to citizens of the host country.

These PFDI characteristics of smaller companies give them a clear advantage from the point of view of the host country over large-corporations PFDI.

Fortunately, interest in PFDI in developing countries has increased recently among the smaller companies of the industrialised countries, probably because of adjustment problems the companies face in their home countries. However, it is quite obvious that, without internationally co-ordinated policies, these companies will follow large corporations into the semi-industrialised countries.

In addition to such North-South movement, there are signs of a pledging, but rapidly growing, South-South investment of small or medium scale. Here again, however, the tendency seems to be that the more advanced developing countries are strongly preferred as investment locations.

CHAPTER 3: A POLICY OF MUTUAL BENEFITS

The heavy concentration of prevailing PFDI and the potential small and medium-sized investments raise a policy problem: how can low-income countries improve their chances of attracting these investments? Of course, PFDI cannot be lured to the low-income countries at any cost. It is important that policies both attract PFDI and assure a satisfactory performance. It would be a sad commentary if the low-income countries would have to repeat the painful lessons of the more advanced developing countries, instead of benefiting from their experience and designing policies which assure performance in accordance with the host country's development goals. This target can, however, only be met if policies are developed and executed in close co-operation between home countries and host countries. The following sections outline what such a co-operation might be.

The guiding principle of the proposal is that it must be politically feasible and stable, a goal that only can be achieved if the policy package is appealing to all parties concerned. Before outlining the major elements of the proposal, it may, therefore, be useful to explore possible positive interests of the parties involved.

3.1 Interest of the Investors

For an investor, the attractiveness of PFDI in low-income developing countries depends on the expected rate of return and the risk involved. The traditional approach used to attract PFDI to developing countries has been the assurance of high rates of return through excessive incentives in order to overcompensate the investor's risk. This system has worked reasonably well for large-scale PFDI, however inefficient and irrational it may be.

Any incentive system of a host country that provides high profits for PFDI can be understood as a subsidy of foreign investors at the expense of the host country. A subsidy by the poorest of the developing countries does not appear justified on any economic or ethical ground. It is simply irrational that home country companies receive a subsidy from host countries which is paid indirectly by the home country government's aid and debt relief. It appears to be much more rational and efficient for the home country government to carry the subsidy right from the beginning; the host country is not later on humilated because it becomes dependent on the good-will and charity of the home country.

Apart from this general objection, it appears quite likely that the old system will not work for small-scale PFDI, because small-scale PFDI has a different risk structure. If an investment of a large corporation in a developing country fails, the losses incurred usually can be balanced against profits from other projects, because the project accounts for only a small percentage of the entire investment budget. In small companies, an investment in a developing country frequently absorbs such a substantial proportion of the available investment budget that a failure endangers the survival of the company. An expected high rate of return, therefore, can hardly compensate risk considerations. It follows that policies which intend to make such PFDI attractive primarily have to reduce the risk element.

3.2 Interest of the Host Country

The host country's interest is to obtain at low social costs PFDI which would help reach the country's development goals. The host country also faces the risks that the foreign investment is either more costly or less beneficial than expected or that it fails altogether. It appears that the latter is more feared by many developing countries than the former because of possible consequential damages for complementary investment projects. It has been argued that the failure of an investment project in a developing country is much more damaging to the entire economy and the execution of the development plan than in an industrialised country where one investment is only a negligible element of a large multitude of investment projects.

Host countries suspect that PFDI from small and medium-sized companies of the industrialised countries is less certain to succeed than PFDI from large corporations. It probably has to be conceded that this apprehension is not entirely unjustified, because small companies are less experienced in the international investment business and have not the financial backing of large corporations which can sustain a longer loss period in a particular project. Hence, small-scale PFDI will only become as attractive to the low-income countries as their large-scale counterparts, if the risk of failure is reduced. A policy package can actually make these investments more attractive, because, as outlined above, they are more appropriate for this type of countries. Up to now, the lack of experience with these investments has hindered the understanding of their potential benefits.

3.3 Interest of the Home Country

The interest of the home country is somewhat different. On the one hand, there is substantial concern in home countries about the increasing concentration of monopoly power in the hands of a few large corporations. Most industrialised countries, therefore, have designed policies to assist the smaller companies in their struggle for survival against the large corporations. All these schemes have a number of subsidy elements.

Policies for PFDI of smaller companies in low-income countries designed to strengthen the chances of the companies' survival will clearly be in the interest of the home country. It may eventually even make funds obsolete which are presently used for subsidising these companies.

Another concern in home countries is the recent practice of granting debt relief and certain forms of programme aid. There seems to be no control over efficient utilisation of these transfers. Whether or not these concerns are justified is not to be discussed here. If a policy package for small-scale PFDI could help to reduce the need for debt relief and uncontrollable forms of aid, this will certainly be in the interest of home country governments.

CHAPTER 4: MAIN ELEMENTS OF THE POLICY PACKAGE

Growing out of the interests of the above parties is the following proposal for the promotion of small-scale PFDI in low-income developing countries:

- Reduce the risk of the small investor by granting him a comprehensive guarantee of his investment and a minimum rate of return.
- Reduce the risk of the host country by carefully selecting and screening projects as well as investors through a politically neutral international agency.
- Assure an adequate performance of the investments through participation of home country governments in the screening process and the monitoring of projects, as well as through performance guarantees provided by the home country governments.

It must be emphasised that this proposal makes sense only as a package and that objections which obviously could be raised against individual elements do not necessarily hold against the package as a whole.

4.1 Risk Reduction for the Investor

With regard to the risk of the investor, it may be argued that all home country governments already provide investment insurance schemes which sufficiently cover investment risk. However, up to now all these schemes cover only political risk and not economic risk. A political risk coverage is sufficient for large corporations but not for small companies. The latter need, for the reasons already mentioned, an economic risk coverage. Otherwise they will invest only in countries where long and extensive investment activity of the large corporations makes the economic risks look small.

Another objection could be that economic risk coverage by the home country government transfers all the risk to the government and thus induces investors to venture into all kinds of risky projects, without sufficient economic justification. This certainly is a valid objection which, however, can be eliminated by giving the home country government a decisive role in selecting and monitoring the projects executed by its investors. Administratively, this task may be delegated to a special national agency which co-operates with an international agency as specified below. In addition, it may be noted that the proposal barely differs from the established practice of giving grants and providing debt relief. If the grants or the loans are understood as provision of finance for (unspecified) investments which neither carry profit for, nor are repaid to, the original supplier of finance, this is equivalent to a complete risk carrying by the respective government.

A guarantee of a minimum rate of return lowers the small investor's risk of tying a major portion of his investment budget to potentially unprofitable projects. It, therefore, may effectively encourage the investor to undertake a project in a less developed country instead of investing in more advanced developing countries where a satisfactory rate of return appears more likely. However, the concept of a guaranteed minimum rate of return could also encounter two major problems which must be carefully considered before it is implemented: (i) a government-guaranteed income for capital owners may raise objections from labour representatives of the home country; (ii) the investors could gain an unfair advantage vis-à-vis local competitors in the host country.

Objections from labour representatives are likely to arise mainly if the rate of return appears to be excessive, because this may have adverse distributional consequences. However, it is not to be expected that such excessive rates will be agreed on by the home country's administration. Where objections are raised, they have to be settled in negotiations. The problem of unfair competition is basically more serious, but probably not very relevant in practice. First, the host country government as well as the international agency will hardly propose projects for foreign investors if local producers exist, and second, with the type of local production existing in low income countries (mainly handicraft type of activities), competition between local producers and foreign investors will be rare. The official institutions involved in project selection must assure that foreign investors do not compete with but strictly complement local producers.

4.2 Risk Reduction for the Host Country

If the selection and monitoring of projects are combined with a selection of appropriate and reliable companies, the reluctance of host country governments vis-à-vis PFDI from smaller companies is also mitigated. The selection process, however, must actively involve an international agency which is considered neutral by the host country. Host governments certainly will fear that national agencies of the home countries are politically biased. The involvement of an international agency, therefore, becomes imperative. The policy package, then, has to be embodied institutionally in the host country government, in the home country government and in an international agency which the host countries consider neutral. In this framework the provision of guarantees by home countries for the performance of their investors would not only significantly help to reduce the host country's risk, but would also become politically acceptable.

4.3 Performance Guarantees

The proposed selection and monitoring process should not only avoid investment failures, but also assure that the performance of the investing companies is satisfactory. This implies, first, that the investment contributes to the achievement of the host country's development goals (goal performance), second, that the expected contribution is clearly expressed in the contract between the host country and the foreign investor and, third, that the investor honours contract terms (contract performance).

An important conditi for a satisfactory goal performance is that PFDI takes place in appropriate projects with the appropriate technology. Past disappointments with PFDI goal performance mainly stem from the lack of adequate policies and control mechanisms by which appropriate PFDI is selected and channelled according to the host country's development priorities. By establishing a thorough selection process and a careful monitoring for PFDI, the present proposal can be expected to avoid this problem.

For the same reason, contract non-performance will rarely occur. The major cause of most contract non-performances, an unresolved conflict between the interests of the investor and those of the host country, is practically non-existent in the proposed scheme. With a guaranteed minimum rate of return, the investor has no strong motivation to deviate from agreed contract terms, even if unexpected changes of economic data or host country policies threaten to invalidate his rentability calculation.

If the home country government is involved initially in the processes of project selection and evaluation and if the likelihood of non-performance of its investors is low, it is in a position to guarantee the performance. The proposal, therefore, helps pe.formance guarantees by home countries make sense. This clearly is a very important aspect of the proposal.

4.4 Possible Objections by Home Countries

It could be argued that the proposal cannot be in the interest of the home country, because PFDI of the smaller companies will have significant negative employment effects in the home country, particularly in branches and regions where structural problems already abound. This proposition appears incorrect for the followin reasons:

First, the subsidies would keep companies in existence which otherwise may have disappeared. Second, PFDI is certain to generate exports, particularly capital goods, from the home country which cannot be produced in the host country. Third, exports from affiliates established in low-income countries to the home country are unlikely to gain any significant importance, as the so-called "run-away industries" are typically going to intermeidate-income countries. In fact, the United States Overseas Private Investment Corporation (OPIC) has estimated that the projects it insured between 1974 and 1977 have not only helped to maintain jobs in the United States, but created an additional 37,500 jobs in the United States. This, of course, is mainly explained by the fact that OPIC was urged by the US Congress in 1974 to concentrate its activities in countries below the $ 450 income level, and that the respective projects mainly serve the domestic needs of these countries.

The proposed appreach seems, therefore, to be attractive to deve oping countries as well as developed countries. The good experience OPIC has had with its recent concentration on low-income countries and its complementary financing of such projects at favourable terms suggests that the proposed approach could be successful.

CHAPTER 5: A TRIPARTITE CO-OPERATION

Smooth implementation and operation of the policy package require close co-operation among the three parties involved: the host country government, the home country government, and the international agency. The co-operation will be, if the tasks of each party are defined.

5.1 Tasks of the Host Country

Although there are several interests involved, the interest of the host country to further its economic development should have priority. The host country, therefore, has to establish a number of conditions which assure that the development objectives are met. It further should spell out in detail any regulation it wants to impose on PFDI so that the projects can be properly evaluated. It appears that the following tasks would be an indispensable contribution by the host government to the policy package:

First, the host country government establishes, or enlarges, the responsibility of a national investment agency, which is in charge of the execution of the proposed programme.

Second, it specifies what development priorities are a precondition for identifying suitable projects.

Third, it provides investment guarantees against outright and creeping expropriation. Although this is of no importance to the investor, whose risk is fully covered by the home government, it will serve to create a good investment climate and encourage the home government to implement the programme forcefully.

Fourth, the national agency establishes a project pipeline. This can be done in co-operation with the international agency, which in turn can request technical assistance from the home countries.

Fifth, it establishes and monitors, through the international agency, contacts with the foreign investors.

Sixth, it assists in creating contacts between foreign investors and potential domestic participants.

Seventh, it specifies in detail the conditions for capital transfer and repatriation, profits repatriation and reinvestment, import of raw materials and capital goods, export of products, and utilisation of domestic resources (labour, domestic capital, natural resources).

Eighth, it gives the final approval for all PFDIs which are implemented.

5.2 Tasks of the International Agency

The success of the policy package essentially will depend on how strongly it is supported by the international agency. The agency's tasks will be the following:

First, the international agency propagates in low-income developing countries the identification of development priorities and the establishment of project pipelines and generously provides technical assistance for this purpose.

Second, it smoothly processes project proposals from the developing countries and forwards them, together with its evaluation, to the respective agencies of the home countries.

Third, it actively co-operates in the selection of suitable investors.

Fourth, it provides loans to investors for projects which have been approved by the agency itself and the home country. The loans should be provided at normal market conditions and financed from funds raised on the capital markets of the developed countries. Because of the guarantee by the home country government, financial losses due to default of debtors cannot occur.

Fifth, it endorses a performance guarantee to the host country for those projects for which it obtained an equivalent guarantee from the respective home country.

Sixth, it endorses investment guarantees by the host country for approved PFDI.

5.3 Tasks of the Home Country

The tasks of the home country can be described as follows:

First, the home country government establishes or enlarges the responsibility of a national investment agency which represents the home country's interest in the execution of the policy package.

Second, it gives a performance guarantee vis-à-vis the international agency for those investment proposals by private companies which have been approved by the home country's agency.

Third, it provides a comprehensive guarantee to the investor on his invested capital and for a specified minimum rate of return. This guarantee may be tied to certain execution rules and accounting procedures on the side of the investor which the national agency may stipulate.

Fourth, the national agency evaluates and approves projects proposed by the host country and approved by the international agency.

Fifth, it disseminates information on approved projects to potential investors.

Sixth, it evaluates responses by investors and forwards the responses with its comments to the international agency, which in turn forwards them to the host country for selection.

Seventh, it gives technical assistance to the international agency if required.

5.4 Special Regulations for South/South Investment

The proposed role of home countries is unlikely to be played as well in developing countries as in developed countries. Special regulations, therefore, must be specified for South/South investment. These refer mainly to guarantees provided by the home country government. It is unlikely that a developing home country can equal a developed home country in far-reaching investment guarantees to its investors and performance guarantees. However, if these guarantees are not provided, investments from developing countries would be at a tremendous disadvantage vis-à-vis those from developed countries.

To avoid this, it appears advisable to establish a special fund, financed primarily by industrialised countries, which backs up guarantees for investments from the developing countries. The fund would be administered by a small professional staff, which would assume the above-described responsibilities of the home country's national agency for the investments. The staff should be involved in the project approval and able to veto projects, because the responsibility for approval and comprehensive guarantees cannot be separated. Any developing country would, of course, be free to choose the same procedure as has been described for industrialised countries, i.e. to guarantee on its own PFDI undertaken by its citizens.

CHAPTER 6: THE INSTITUTIONAL SETTING

Institutional arrangements in the field of international investment are difficult to establish, as the unsuccessful attempt to create an International Investment Insurance Agency amply demonstrates. However, the outlook may be less discouraging, if one deals with an entire set of policies, where it is easier to balance out the benefits accruing to different participants, than if one deals only with one particular policy measure.

Benefits of the proposed policy package will accrue at different times for the host countries and home countries. Whereas the former are likely to derive immediate benefits, the latter will have to pay the costs in the beginning and derive the benefits only later on. This suggests that the institutions entrusted with the implementation of the policies should have extended missions. Ad hoc commissions certainly could not do the job. The personnel required for project selection and evaluation, furthermore, can only be built up over time.

As several international institutions already are involved in comparable activities, it is reasonable to ask, whether any of them could adopt the task.

Since the adoption of the Lima Declaration and Plan of Action, the responsibilities of UNIDO in the field of industrialisation of the developing countries have been substantially enlarged, thereby well equipping UNIDO, in principle, to execute the proposed programme. Existing financing institutions, such as the World Bank, are not in a position to handle projects heavy subsidised by individual home governments. Another problem in such institutions is an unequal voting power which violates the neutrality principle.

A precondition for a successful implementation of the proposed programme would, therefore, be that the voting power in the institution is equally divided between home countries and host countries, possibly with a veto right for the majority of each group. Only equal participation can assure that no one feels dominated or overruled and that the policies are smoothly implemented without unproductive ideological confrontation.

CHAPTER 7: COSTS AND BENEFITS OF THE POLICY PACKAGE

The major goal of the proposed policy package is to remove the low-income countries from the low-level equilibrium trap. It is hoped that the widening of disparities between the low-income countries and the industrialised and developing countries can be ended and eventually be reversed.

In assessing the benefits, one may concentrate, therefore, primarily on income and employment creation in the host countries, with the expectation that selection of suitable projects will provide positive distribution.

The costs of the package may be estimated in terms of the budget supplied by the home countries. This is, of course, a short-term calculation, as it neglects all benefits which accrue to the home countries in the long run through the conservation of jobs, increased exports and the supply of raw materials.

For the sake of simplicity, the estimation of costs and benefits is given for the group of low-income countries as defined by the World Bank. Total gross national product of this group amounted in 1976 to roughly US $ 200 billion. Assuming an increase of investment as a share of GDP of, alternatively, 5 and 10 percentage points, what usually is considered to be required for the achievement of a significant acceleration of income growth, the additional investment would come respectively to US $ 10 and US $ 20 billion annually. If one assumes a "loss rate" of 20 per cent, which would have to be covered by the home countries, this amounts respectively to US $ 3 and US $ 6 per inhabitant of the industrialised countries or respectively 0.05 and 0.1 per cent of those countries' Gross National Product. The quality of the project management probably will increase through experience and soon reduce the loss rate. In the long run, the debt relief now granted to the poorest countries would largely become unnecessary.

With an assumed capital-output ratio between 3 and 4, assuming that the PFDI will not be highly capital-intensive, the average increase in the annual real rate of growth will range from 1.3 to 2.5 percentage points.

This would significantly contribute to the lowering of the disparities between these countries and the rest of the world. With per capita growth rates more than doubling, it would also be a significant improvement for the masses of the population in these countries, provided the projects are accordingly selected.

The direct employment effect would also be substantial. Assuming that on average one job could be created for every US $ 15,000,[2/] the annual job creation would range between 600,000 and 1,200,000. This may not sound much in view of the high rates of un- and

underemployment in these countries. However, if one considers that FFDI is likely to have indirect effects on the rest of the economy and that US $ 15,000 per job created is already a fairly high figure, total annual employment creation could be in the range of 2 million to 4 million jobs. Over a period of 10 years, this could mean up to 40 million jobs. In view of an International Labour Office projection in which annual employment creation has to be at least 2 million jobs, if the present unemployment situation in the developing countries should not deteriorate, the proposed programme appears to make a very significant contribution indeed.

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THE STATE MONOPOLY OF FOREIGN TRADE IN THE USSR:
THE EXPERIENCE AND CONCLUSIONS OF INTEREST FOR DEVELOPING COUNTRIES
(The Case Study of the Soviet Machinery Import from the Western Countries)

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INTRODUCTION

The Marxist-Leninist economics recognises that foreign economic relations, including the machinery import, are a major factor in efficient economic growth. The Soviet Union from the beginning has relied on its own national resources, but as the XXV CPSU has stressed, development in any country today increasingly employs an international division of labour.

Possessing R + D and industrial capacities, the USSR has become a large exporter of machinery and equipment, particularly to socialist and developing countries. Macro-economically, the foreign inputs play only a supplementary role in our development process. Nevertheless, we need a window to the world technological innovations and do import foreign machinery and complete plants, if these offer new or unique technology, may support domestic technological efforts or save time and production costs. The imported hardware and software modernise domestic enterprises, set up new production lines, strengthen our own export sector. The Soviet import plans and state technological policy take into account advanced technologies emerging abroad.

To be more specific, the purchases of machinery and equipment, always the main item on the Soviet import list during the post-war years amounted to about Rbs. 75.2 billion; machinery parts equalled about 1/8 of USSR imports in 1971 and 1975 and are now about 16 to 18 per cent.

Principal import sources are the socialist countries, members of the Council for Mutual Economic Assistance (CMEA). However, because of our growing foreign trade and the climate of détente, about one third of the imported machinery now originates in the developed market economies. Soviet buyers and foreign trade organisations (FTOs) have gained much experience in managing purchases from abroad and defending their interests. Such experience enables us to improve the Soviet import planning and negotiating technique. The experience may also have international significance, particularly for the developing countries, which, although major importers of machinery and equipment from the West, lack enough bargaining power and are, consequently, fighting for restructuring the international economic relations on a fair and democratic basis.

Therefore, the main purpose of this study, prepared on the request of the UNIDO Secretariat, is to gather and to analyse the Soviet experience particularly as it could be applied by developing countries. For this purpose, the study ends with a number of recommendations, put forward by the author in his personal capacity and cross referenced with the relevant aspects of the Soviet practices described in the main part of the text.

CHAPTER 1: THE SOVIET MACHINERY IMPORT FROM THE WEST: REGIME, PLANNING AND MANAGEMENT

The USSR policy of machinery import is to achieve the maximum, multidimensional effect for our economy and, simultaneously, to accommodate the commercial interests of our partners through mutually beneficial contracts. These intentions can be realised, however, only if equal and fair external environment exists for such trade, its efficient planning and skillful management. To that end, the USSR relies on the planned development within her own territory, the monopoly of foreign trade on its borders and the continuing efforts of its diplomacy aimed at the legalising in the international trade such principles as the equality, mutual benefits and non-discrimination, echoed today in demands of developing countries for a New International Economic Order (NIEO).

1.1 The Soviet Experience in Ensuring the Equal and Fair Regime for Trade

The Soviet Union easily understands the desire for a NIEO because as the first socialist country, it challenged an old economic order. During most of its history, the USSR was treated by many Western countries as an anomaly, unentitled to enjoy normal trade policy and commercial conditions. The Soviet economic diplomacy has managed to normalise this situation to the large extent, but discrimination still exists. NATO countries, for example, prohibit the export of some research-intensive products and related technology to the USSR, depriving us of most favoured nation treatment. Extra non-tariff barriers are applied specifically to the Soviet exports; credit and administrative restrictions exist.

Being alone in such unfavourable environment, the USSR has had practically no chances to protect its interests in the framework of the multilateral trade policy. Nor could we afford to associate ourselves with many of the international trade and monetary organisations or agreements designed to serve the market economy dominated by the Western countries and protecting the old, non-democratic world order. This is why our instruments to cope with foreign trade problems were and still are predominantly bilateral, i.e. aimed at avoiding confrontation with the Western countries as a group (its common position usually that of its extreme members). Dealing with them on the country-by-country basis has helped achieve bilateral breakthroughs and make such advancements more widely acknowledged norms. This appreoach has then been shared by other socialist countries (see recommendation 5).

Initially, these instruments were traditional bilateral trade and navigation treaties, regulating only the general regime for mutual trade. However, from the beginning, they included some innovations, reflecting the specific modalities of our external economic relations, primarily the state-trading, and thus provided the Soviet FTOs with the legal basis to be the parties to the foreign trade transactions.[1/]

1/ Two principal innovations are legalising the state trading organisations as the full-fledged contractual partners and the understanding to allow USSR trade representations in respective countries. Their functions include contacts with local authorities and

However, the tasks of our intergovernmental treaties are not limited to ensuring juridical equality for the state-trading organisations. In the planned economy, these treaties are the external arms of our planning, designated to expand and to diversify our foreign economic relations in accordance with national goals and priorities. This is particularly true in the case of the new generation of these instruments, namely the long-term agreements on trade, economic, industrial and technological co-operation and the long-term implementation programmes. Detente and the continued normalisation of East/West trade conditions have allowed the instruments in their regulatory aspects to extend the advanced forms of co-operation, previously used only within the CMEA. Because agreements are made with our series of five-year plans in mind, they serve as a "blueprint" for subsequent contracting (see recommendation 5).

Their successful implementation has clearly shown that it is simply impossible today to be a major Soviet trade partner without such an agreement and programme, particularly in machinery trade.[1/] The Western officials and businessmen give these declarations of intentions serious considerations before being convinced that the agreements (programmes) may be properly realised subject to the mutual good will. Consequently, we can achieve more progress in bilateral (and as a cumulative effect in overall) normalisation of East/West trade. In a way, it contributes to our bargaining power on the contractual level as well, since many corporations (particularly those having corporate planning) are eager to avoid uncertainty and a lack of predictability, dominating many sectors of the volatile world market today (see recommendation 2). The other lesson is that corporations from countries pursuing the most restrictive policy towards the USSR are unable to compete in the Soviet market. For example, since the adoption of discriminatory trade legislation in 1974, US corporations have lost the Soviet orders of more than Rbs. 3 billion, which have been redirected, on a competitive basis, to Western Europe and Japan.

Under the climate of détente, the USSR is also progressively involved in multilateral diplomacy with a view to normalising international trade as well as to protecting our regional and global interest. The Conference on the Security and Co-operation in Europe, which culminated in the Helsinki Act and the subsequent meeting in Belgrade stands as proof.

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direct contacts with local enterprises, the inspection and acceptance of the products to be shipped to the USSR, dispute settlements, market research, trade promotion. The representations are established now in 70 foreign countries. In 32 other countries their tasks are performed by the offices of the Commercial Counsellors within the Soviet Embassies and protect our national economic interests abroad accordingly. Nowadays, when the state-trading is no more an anomaly but the paradigm of the modern trading process, such practice deserves attention (see recommendation 3).

1/ For example, each Soviet-French long-term agreement concluded for the periods 1966 to 1970 and 1971 to 1975 stipulated the doubling of trade turnovers which were overfulfilled. In 1975 to 1979 it was intended to increase the mutual trade again by two and, if possible, three times; this is now close to the reality. The USSR and Finland have more than 25 years of experience in such co-ordinated trade and their long-term programme until 1990 stipulates the growth in the mutual trade increases Rbs. 9 billion from 1976 to 1980 (actually it is expected to be Rbs. 10 billion), Rbs. 12 billion from 1981 to 1985 and Rbs. 14 to 16 billion from 1986 to 1990. Similar agreements (programmes) are in force with such countries as the United Kingdom, the FRG, Italy, Austria , Belgium and Luxembourg.

The Act has legalised and opened new avenues for long-term, large-scale business co-operation on both bilateral and multilateral bases, with due regard to the interests of developing countries. The USSR is among the supporters of a restructuring of the international economic relations on a fair and democratic basis and actively collaborates to this end with the developing countries within the United Nations.[1/]

It ought to be clearly stressed, however, as important as diplomacy is, the foundations of USSR's pursuit of equality and non-discrimination are our own developed and diversified economy and the socialist economic integration within the CMEA. In particular, after the ban to export modern computers to the socialist countries, CMEA developed its own technology, embodied in the computers of the "RYAD" family. After Ford Motors' refusal to be the general contractor for the Kama heavy truck complex, the engineering services were performed by the Soviet institues Giproautoprom and Giprodvigatel. US equipment has been partly replaced by other sources, including domestic (see recommendations 1, 7). Finally, the Soviet market, stable and free from cyclical fluctuations, always generates the keen competition among would-be suppliers which provide us with some bargaining trade-offs. In other words, the USSR, initially economically weak and politically isolated, has managed to create the reliable combination of domestic economic strength and an external legal and operational base which enables us to normalise the terms and conditions for our participation in the international trade and to influence restructuring of the existing multilateral commercial policy in accordance with the realities of the contemporary world.

1.2 The Import Plans: Formulation and Implementation

The foreign trade relations in the USSR are the state monopoly. Introduced over 60 years ago, the monopoly has been further consolidated and enhanced in the new USSR Constitution, adopted in 1977. This means that all overseas business affairs are centrally planned and subjected to the national goals and priorities. This means also that, although many economic issues in the USSR are regulated by the legislations of the individual Soviet republics, the forms of the foreign trade transactions and the procedure for concluding and implementing them is determined by the legislation of the USSR, i.e. all-union law (see recommendation 5).

Finally, this means that all transactions with foreign markets are concentrated in the hands of the specialised organisations, FTOs which act as the merchant commissioners under instructions of the Soviet customers (usually all-union or Republic industrial ministries or organisations) and the supervisions of the authorised governmental bodies. Specifically, the FTOs dealing with machinery imports belong to the system of the USSR Ministry of Foreign Trade.

1/ Through their concerted efforts, the United Nations, particularly UNCTAD, adopted such fundamental documents as the General System of Preferences, the Charter of Economic Rights and Duties of the States, the Code of Conduct for the Liner Shipping Conferences. Similarly, the positions of the USSR and the developing countries are close on the drafts of an International Code of Conduct for the Transfer of Technology, a Code of Conduct for Transnational Corporations, on a Set of Rules on Restrictive Business Practices, etc. now under elaboration within UNCTAD and other UN bodies (see recommendation 10).

The machinery import to the USSR is effected within the framework of the import programmes, embodied in the foreign trade aspects of the national economic plans. These plans are elaborated on a five-year basis but divided into annual blocks. The import programmes contain targets, expressed in the total volume of the import and its structure, divided by the geographic and currency areas. The general import targets for each of the areas are determined by the expected export proceeds and net inflows of foreign credits. Specifically, these programmes take into account the USSR's declared intentions and commitments, contained in our bilateral and multilateral agreements mentioned above. As a whole, this monopoly of foreign trade is a part of the socialist legal and management infrastructure aimed at ensuring our sovereignty over the national development (see recommendation 2).

Technically, programmes of imports are worked out by the State Planning Commission (the Gosplan) on the basis of the requests from the industrial ministries and other authorities concerned, as well as the opinions and assessments of the Ministry of Foreign Trade, Ministry of Finance and the Vneshtor bank. In their final version, these take the form of lists of major projects with the approximate individual currency allocations for their "foreign content". The major decisions concerning imports are made by the USSR Council of Ministers.

Nevertheless, whatever weight these high echelons have in the import planning, the particular responsibility for the proper selection of the machinery and equipment to be imported belongs to the sectoral industrial ministries, which in the USSR are the main architects of the technological policy in their respective sectors. Therefore, their request before the Gosplan has to specify, inter alia, the following: an expected effect of the project for the national economy; its securing with the internal financing and the material technological and manpower supply, its sound territorial location; the needs for the inter-industry co-operation, including foreign subcontracting; raw material supply; transportation and marketing prospects as well as a review of the foreign markets concerned and the currency appropriations. Particular attention is paid to the technological level and performance of the would-be imports and to their installation and commissioning in accordance with the schedule. The governmental authority, responsible for the practical implementation of the commercial aspects of the import plans is the USSR Ministry of Foreign Trade, which has both supervising (the Central Machinery) and operational (FTOs) bodies (see chart 1)

The Central Machinery formulates the draft import plans, assesses the domestic requests and foreign offers for imports, studies the terms and conditions in machinery trade, elaborates the model contracts, issues the import licences, co-operates with the Soviet customers etc. In the area of the machinery import, its principal divisions are the Main Department on the Machinery Import from the capitalist countries and the Main Department on the Compensation Deals. Also involved are the Main Legal Department, the Main Currency Department, the Main Engineering Department as well as the transportation, information and regional departments.

The FTOs, in turn, play the parties to the actual foreign trade transactions, concluded by them in the context of the import programmes and under instructions from clients. The machinery import is performed mainly by 14 FTOs (see chart 1), strictly specialised in the particular types of machinery, playing their sole importer in the USSR, thus not competing among themselves and not giving the foreign suppliers chances to make them rivals.

Under the recent legislation, each FTO is an independent economic complex operating on a profit-and-loss basis and consisting of the several specialised firms (profit-centers) entering on behalf of the FTO into business transaction and issuing respective requests, offers and orders (see chart 2). Legally, the FTOs enjoy the rights of juridical persons, have their accounts with the Vneshtorg bank and are entitled to enter any lawful business transactions.[1/] The FTOs are not liable for the obligations of the state and vice versa. Summing up, these are very flexible instruments, since, although they perform the state monopoly, their transactions do not require any ad hoc legislative approval and do not involve the state as such and, what is also important, they are well able to play the countervailing power to the transnationals (see recommendation 3).

1.3 The Import Decision-Making and the Negotiating Process

The positive effect for the Soviet economy from the machinery import is secured by the concerted efforts of the customers and FTOs. On the basis of the import programmes the customers issue to the FTOs the import orders, containing the basic data for the subsequent commercial actions.[2/] The FTO transforms the order into the formal commercial requests addressed to the foreign suppliers. The rule of thumb is that the requests ought to be sent to all well-known suppliers of the machinery in question with a view to promote competition among them and to all corporations that have shown themselves as the fair and reliable partners in previous transactions with FTOs.

1/ For example, under its chapter, FTO "stanko-import" is authorised to:

- perform, both in the USSR and abroad, all kinds of transactions and other legal deeds, including those of purchase and sale, barter, contract, loan, transportation, insurance, agency and commission, storage, joint activities, and others, with institutions, enterprises, organisations, societies, partnerships and individuals; and also participate in tenders and competitions, and give guarantees;
- to build, acquire, alienate, lease and rent, both in the USSR and abroad, enterprises auxiliary to its activities as well as all kinds of movable and immovable property;
- to establish its affiliates, offices, divisions, missions and agencies, as well as establish and participate in all kinds of organisations whose activities comport with its tasks;
- to act as a plaintiff and defendant in courts of law and arbitrations; conclude amicable settlement;
- to participate in international fairs and exhibitions and also participate in or organise specialised exhibitions, symposia; publish advertising literature;
- to ensure the participation of responsible representatives of relevant ministries and departments of the USSR in negotiations on the conclusion of major contracts for the export and/or import of goods specified as its area of responsibility.

2/ These are the titles and quantities of the machinery concerned, the desired schedule for deliveries and, for complex projects, also the pattern and volume of the technical assistance, engineering and consulting services required. These orders predetermine the technological contents of the forthcoming deals, since the FTOs cannot introduce any changes into the customers' specifications without their permissions and are in charge for the commercial aspects of the deal only, i.e. have to place the given order on the best contractual terms possible.

The requests usually contain the titles of the machinery and equipment, their specifications and desired characteristics (capacity, productivity, dimensions, energy consumption, weight etc.). Normally, the FTO does not indicate prices it might pay since the requests are aimed at collecting competitive bids and may specify, if necessary, only how price is to be established and the terms of payments. In case of equipment packages, the would-be suppliers are invited to unpackage, that is, to indicate individual prices of machinery and technology, as well as to state clearly what set of the technical services they would include in the contract. The requests specify delivery schedule and the deadline for placing the bids.

The bids received become the "competitors' list", which is the basic pre-negotiating document to be studied by the FTO and the customer in order to choose the most promising offers. Sometimes the customer is requested to prepare the separate assessments on each bid selected with recommendations as to which negotiations would be worthwhile. The same assessments have to be prepared if the project (contract) is initiated by the foreign interests. For example, during the last session of the US-Soviet Trade and Economic Council (December 1978), the Soviet side was given 28 offers on the projects for co-operation and then transmitted them for assessments to the Soviet ministries and authorities concerned. In the case of a unique or complex project, the foreign corporations may be invited to place the preliminary bids or feasibility studies.

In selecting the specific partners for the actual negotiations from the "competitors' list", the FTOs are guided usually be technological records, financial positions, business reputation, by the previous experience, the opinions of the USSR Trade Representations in the respective countries, other Soviet FTOs and sometimes the FTOs of other socialist states. The Market Research Institute of the Ministry of Foreign Trade may also be useful, because it maintains records on many foreign corporations, including all regular partners of the Soviet FTOs. The records consist of the basic data on these firms and supporting information on their business performance (see recommendations 6, 8, 11). The partner may be freely selected within the currency zone, specified in the import plan or within a given country, if the project in question is specified in the respective bilateral agreements (programmes). For example, under the Soviet-Japanese long-term trade agreement for 1976-1980, the suppliers of complete plants for the production of ammonia, fertilizers and synthetic rubber were selected among Japanese corporations.

The aforementioned in no way implies, however, that the Soviet market is inaccessible for the newcomers or for the small and medium-sized firms. Our established policy is to diversify the sources for machinery imports, FTOs are obliged in any case to have in the "competitors' list" a certain number of offers and not to discriminate against any bidding interests.[1/] (see recommendation 4).

1/ As to the small and medium-sized business, the FTOs have several hundreds of such partners in the FRG only. A medium-size Austrian firm "GFM" has already supplied the USSR with 40 forging machines and is awarded with the contract for another 20 until 1980. These firms, at last, may, as an option, play subcontractors and, for example, in the delivery to the USSR of five plants and 10 installations producing ammonia about 800 Japanese firms were subcontracted.

The FTOs do not mind negotiating with individual corporations or their consortia, particularly if this is justified by the project complexity and does not appear aimed at overpricing or distorting the fair competition. Depending on the circumstances, the FTO may prefer to negotiate with several competitors simultaneously. The bargaining over the large projects is usually very detailed and time-consuming.

The gernal contractual provisions are determined by the respective intergovernmental agreements and trade customs. The basis for drafting may be also the model contracts, which every machinery-importing FTO elaborates for its own (see recommendations 6, 9). These cover usually such issues as guarantees, sanctions, force majeure provisions, the procedure for the inspection, testing and acceptance, dispute settlement, etc. The specific provisions, at the heart of the negotiations, are the titles and specifications of the machinery, prices, the basis for price-setting, the delivery schedule, the terms of payments.[1/]

To improve their bargaining skill, the FTOs may have informal meetings and consultations and share their experience. Negotiating techniques are collected and analysed also in the Market Research Institute of the Ministry of Foreign Trade and studied within the training and retraining facilities, attached to this Ministry.

1/ FTOs do not mind to use also some internationally recognised customs and norms like, "Incoterms", as well as the manuals for the machinery trade, elaborated by the international organisations, for example by the UN ECE, such as "General Conditions for the Supply and Erection of Plants and Machinery for Export and Import", "General Conditions for the Erection of Plant and Machinery Abroad" or "Guide for Use in Drawing up Contracts relating to the International Transfer of Know-how in the Engineering Industry etc (see recommendation 12).

CHAPTER 2: THE CONTRACTUAL DRAFTING

The specific contents of machinery import contracts vary widely depending upon the bargaining environment and the goals of a given transaction. However, as the fair merchant commissioners, the FTOs always seek reliable protection of the interests of the Soviet customers, inter alia, through:

- securing high technological level of imports; their timely deliveries and an adequate access to the technical and engineering services concerned;
- securing favourable terms and conditions of the deals, including prices and terms of financing and payments;
- securing appropriate means for dispute settlement;
- securing the customers' interests in the case of the contract transgression or the supplier's malperformance or misconduct;
- repulsing restrictive business practices, particularly that of transnational corporations.

In specific, these goals are attained in the following ways:

2.1 Securing Proper Technological Characteristics and Timely Deliveries

The foundation for attaining these goals is laid down on the pre-negotiating stage, when the customer is obliged to prepare the exact and clear technological specifications for the machinery and equipment to be imported and then to perform the close examination of the offers received. No less important is the inspection, testing and acceptance of machinery and equipment contracted. Normally, some of their elements or blocks may be inspected and tested abroad, at the supplier enterprise, particularly if the production process needs to be controlled in order to complete the shipment or to test pilot specimens. Besides, this saves time and money that would be lost if substandard or unproperly designed and assembled machinery were delivered to the customer. The contracts stipulate that elimination of defects during the tests cannot extend delivery deadlines.

The object for acceptance sometimes is technological documentation prepared by the supplier,[1/] particularly in cases of major complex projects or if the supplier is involved with preinvestment engineering and consulting. These functions are performed by the

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1/ The contractual technical documentation in the Soviet machinery import practice may consist of all or any of the following:

(i) General view drawings of the equipment concerned and of its most complicated parts with indication of main dimensions and characteristics, as well as detailed specifications;

(ii) Foundation, assembly and installation drawings;

(iii) Working drawing of parts wearing out rapidly and itemised list of spare parts;

(iv) Instructions for erection, commissioning, testing, starting operation; maintenance and control measuring devices; lubrication, electrical, pneumatic, kinematic schemes, instruction for safety engineering;

(v) Other specific relevant documentation, in quantity and quality adequate for running the project by local personnel (see recommendation 9).

specialists sent abroad by the customer to inspect or participate jointly with the supplier's staff in the preinvestment engineering, feasibility studies and adaptation of the technology concerned (see recommendation 1). For example, the FTO Autopromimport arranges hundreds of missions abroad per year, including for joint engineering. This has been done, for example, in Pittsburgh, Pa. (USA) with equipment ordered for the Kama heavy truck plant.

The relatively simple, standard or non-complete machinery normally may be accepted abroad. However, the final acceptance of the equipment - particularly of complicated equipment - occurs after its delivery, its assembly, installation and commission. The criteria for this final text are the technical specifications stipulated in the contract and, in particular, the compliance with the guarantee parameters (productivity, input, output, quality etc.) and the technical (ecological) standards concerned. The parties may wish to use any existing international standards, but normally the yardsticks are the USSR state standards, which are mandatory within the USSR territory and of particular importance, since in the Soviet practice any project - even turnkey types - have local contents and thus foreign inputs have to be technologically compatible with the domestic machinery and the technology involved (see recommendation 1). In addition, standardisation in the USSR is an instrument to speed up the technological progress and to secure the investment into contemporary technology (see recommendations 6, 8).

A team, consisting of the customer's officials and specialists, the FTO and the supplier's representatives, does final testing and signifies acceptance. Some elements of the imported machinery (for example, vessels under pressure) are to be accepted by the State Technical Inspection (gostechnadzor).

It is of particular importance that a planned economy ensure the timely deliveries of imports and their commissioning in due course. The scheduled deliveries for the large-scale projects usually parallel actual construction and this is why contracts normally contain a fixed-deliveries calendar guaranteed by the supplier. The technical documentation for machinery and equipment is to be forwarded two months in advance.

To ensure the economic and technological efficiency of the imports, the FTOs and the customers may request that importers supply technical assistance through training, specialists' missions, consulting, engineering, installation supervising and servicing. Having developed a technical and economic basis, the USSR sees this assistance as only supplementary, but it is sometimes required, particularly in case of new or unique technology, large-scale projects and during the period of commissioning installations. For example, the Finnish engineers participated in the assembly and commission of smelting equipment at the Norilsk mining complex; in 1975 about 2,500 foreign specialists were engaged in the construction of the Kama heavy truck plant.

The contracts also provide for spare parts and, if necessary, after-sale servicing, particularly within the period of guarantees. Some corporations - on a contractual basis - set up their service centres in the USSR by storing the supplies in the warehouses which belong to the USSR State Committee on Material and Technical Supply.

Entering the contracts, especially complete-equipment import, the FTOs emphasise the suppliers' guarantees as to the technological level, actual performance and reliability of the machinery concerned. Specifically, the supplier may be requested to guarantee that:

(i) the equipment will be designed and produced in full accordance with the most advanced international technological achievements available at the time the contract is executed;

(ii) the equipment will be manufactured and assembled with first-rate workmanship and of the high-quality materials;

(iii) the equipment will be (is) manufactured in full conformity with contractual specifications;

(iv) the equipment and technical documentation is complete, main performance parameters (productivity, energy and raw material consumption, output and its quality, the precision, etc.) as well as patent non-infringement and timely delivery. The parties also establish the length of guarantee and its implementation. This period usually begins when the equipment is installed and is normally negotiable. Some international yardsticks for the specific types of the machinery and equipment may be used as references.

Similar guarantees are widely recognised in the Soviet technology import. Normally, technology licenses are bought for 5 to 10 years; in the machinery industries, 5 to 7 years; and in the complex technological innovations, 8 to 10 years. The rule is, however, not to extend this period beyond patent's validity. The interests of the FTO and the customer are protected also by dividing the initial or lump sum payment into two instalments to be paid upon acceptance of technological documentation and upon achievement of the technology by warranted parameters.

The contract also stipulates the procedure for the implementation of the guarantees agreed upon and the settlement of damage claims. These are rather multi-dimensional and cover defects detected during inspection and acceptance of equipment, the delivery and commissioning delays, malperformance during period under guarantee and some consequential losses causing "development damage".

Specifically, the settlement may require the supplier to repair the defects, replace substandard parts or redraft technical documentation. The guarantee period may be extended if through the supplier's fault the putting the equipment into operation has been delayed or this operation had to be discontinued for a certain period of time. The customers have

the rights to require the supplier to pay the agreed and liquidated damage including the damage for the third persons at the rate stipulated in the contract. This damage is calculated from when the claim is submitted to when defects were eliminated or until the date of delivery of new equipment.[1/] The customers may try to eliminate these defects themselves without prejudice to their guarantee rights. If defects cannot be eliminated or the warranted parameters achieved, the FTO has the right to request the proportional reduction in the contract prices or to cancel the contract shipping equipment beyond repair back at the suppliers' expense and receiving refund of all previous payments, plus interest charges at prevailing (negotiable) rates. At last, if the supplier fails to deliver all equipment on time, all dead freight or demurrage expenses are charged to his account.

To facilitate the settlement procedure, the supplier may wish to use the special (facultative) insurance arrangement, suggested by the Ingostrakh (the USSR Foreign Insurance Agency), which may cover all types of risks involved. However, the pattern and volume of the defects and malperformance detected, as well as the supplier's approach to their corrections are certainly taken into consideration by the FTOs and customers for the future business.

In order to speed up and to simplify the implementation of the contractual obligations, the FTOs prefer to have, particularly in case of the large-scale projects, one general partner (contractor) responsible for the entire contract. However, the FTOs may recommend these general contractors to invite some specific subcontractors, who are well known to the customers and have gained the fair business reputation.

2.2 The Contractual Technique for the Long-Term, Large-Scale Economic and Technological Co-operation. The Settlement of Disputes

The recent shift in the USSR foreign economic relations from sporadic transactions to long-term, large-scale economic and technological co-operation has influenced not only intergovernmental arrangements, but also contractual practices. As to machinery import, the most typical among these contractual innovations are compensation arrangements (pay-back deals), long-term industrial collaboration as well as the agreements on the technical co-operation with corporations advanced in the specific R + D areas.

The compensation arrangements usually stipulate that credit deliveries of equipment for large USSR enterprises be repaid in their products. The pay-back share amounts normally to about 20-30% of total outputs during the life of the contract. This is why these projects

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1/ For example, in case of the delay in delivery the supplier is to pay the agreed and liquidated damage at the rate of n% of the value of non-delivered equipment for every commenced week within t weeks and 2n% for every subsequent commenced week. This damage can be deducted from the supplier's invoices when effecting payments (or can be paid against the FTO's invoide) and is not to be altered by arbitration. Should the delay in the delivery exceed the agreed period, the FTO shall have rights to cancel the contracts in whole or in part without compensation of any damages to the partner caused by the cancellation.

are closely integrated into the domestic economy and able to save foreign currency and to expand export sectors. More than 60 pay-back agreements are now in force. Begun in the mining sector, such contracts have been introduced in a growing number of manufacturing industries, particularly chemistry. They normally extend over two to three Soviet five-year plans; some of them, however, extend beyond the year 2000. In other words, it is the marketing of natural resources, contributing the economic modernisation and progressing from a simple off-setting towards an industrial co-operation.[1/]

Contractually, the pay-back arrangements are regulated by a set of interrelated agreements covering (i) a credit, normally long-term, extended to the Soviet partner; (ii) the deliveries of machinery, equipment and technology (and some related materials, if necessary) and (iii) the purchasing by the Western partner of an agreed volume of the products. The arrangements like these permit machinery importation without spending foreign currency and, at the same time, being settled in kind, do not create the usual money indebtedness and thus ease the overall debt burden.

Additional shipment beyond the original annual quotas may be stipulated also on the normal commercial conditions, as well as the partners' options to buy these products after the agreed expiration date (see recommendation 5).

There is no equity foreign investment within the USSR. All enterprises, constructed on the pay-back basis, as well as all others with "imported contents", are the inalienable property of the Soviet state under its full ownership and control.[2/]

The industrial collaboration is usually arranged through subcontracting, joint production and production-sharing between the Soviet and Western enterprises and sometimes extend to R + D efforts and marketing. The "seeds" for the industrial co-operation are sometimes the licensing contracts with extended commercial provisions, since these allow technology to be put in practice more rapidly and reduce development costs. Industrial co-operation is now underway in the production of the computers, excavators, power supply equipment, machine tools with numerical control, and the Soviet and French coal mines are partly equipped with jointly produced coal-cutting combines "ANF" and "ASKW" (see recommendations 1, 9).

1/ For example, Rbs. 3 billion import of the pipes and pipelines equipment on pay-back basis permits to augment the domestic supply in natural gas in 1976-1980 by about 100 million cubic meters and sell the same volume of it abroad, including to Western Europe and we expect to gain by that (during the existing contracts' timespan and in mid-1970s prices) about Rbs. 25 billion. The USSR and Finland, starting from the pay-back in iron pellets for the Finnish input into Kostomukhshe mining and enrichment complex, study the possibilities for the subsequent production co-operation and specialisation in this area.

2/ There have been some offers for the contractor's participation in the performance of a plant delivered on a profit-and-loss sharing basis and with a limited access to its general supervising. However, there are no projects like these yet and, moreover, the Western partners are recently not particularly eager to launch them, probably preferring the stable source of income to entrepreneurs' risks.

Lastly, technical co-operation sometimes involves the pre-approach to the industrial collaboration and the other forms of long-term business. The bulk of these agreements are concluded between the Soviet State Committee on Science and Technology and the technologically advanced Western corporations for initial periods of 5-7 years with optional extensions or conversion into commercial arrangements. These envisage the joint research and development efforts, an exchange in experts and information, the procedure for the patenting common R + D results. In 1977, there were 16 such agreements with West German firms, 19 with British and more than 40 with American corporations.

Careful pre-negotiating homework, the commitment of the FTOs to their contractual obligations, the interests of the Western partner in having access to Soviet markets (and resulted community of interests in the future business) and the effective restrictions for the transnationals to penetrate the USSR set up by our system of the state property, planned economy and the monopoly of foreign trade, have resulted in few disputes in comparison with the number of contracts concluded. For the same reasons, the FTOs rarely have to re-negotiate contracts.

When conflicts arise, the rule of thumb for a FTO is to try to settle them amicably or within a package without any recourse to a court or an arbitrage. However, the contracts may refer to an applicable law or the procedure for arbitrage settlement. The bulk of the contracts stipulate a recourse only to arbitrage which may take place through the Foreign Trade Arbitration Commission of the USSR Chamber of Commerce and Industry, an arbitrage in the partner's country or, as an optior, third country's facilities, for example, the Chamber of Commerce in Paris or Stockholm.

2.3 Price Setting and the Terms of Payment

The machinery and equipment imported to the USSR are, as a rule unique and complex and thus often have no standard or reference price. Moreover, their suppliers are mainly large Western corporations, including those enjoying market and technological domination and, therefore, sometimes pricing their goods.

This is why the FTOs usually stress unpackaging offers and detailed assessment of the prices offered. Specifically, the FTOs' contracting officers and market research units study the market situation, the prices of the comparable deals, the official and non-official quotations available, the patent situation as well as the limits and opportunities to replace some elements of the package by the domestic contents or imports from the socialist and clearing payments' countries, including developing ones, or by imports from others, more competitive subcontractors (see recommendations 1, 8, 9).

For the large projects, the FTO and the customers normally prepare "shadow" calculations with which the suppliers' offers are to be compared. They unpackage the project, dividing it into several blocks, evaluating each, first to check how correct the suppliers' unpackaging is, then to try to determine the suppliers' profit margin and, therefore, room for bargaining.

Generally, the project costs may be divided into following four blocks:

(i) costs of engineering and technical services;

(ii) costs of technology, equipment and machinery;

(iii) value of construction, installation and commissioning;

(iv) other elements (credit servicing, insurance, taxes, currency risks, etc.)

To calculate the "shadow price" for an engineering input is not extremely difficult, since the bulk of it is normally performed by the domestic organisations. Average domestic rates for services can be compared to those quoted by the respective foreign agencies. Similarly, the construction work, installation and commissioning of equipment are also performed primarily by the domestic organisations, including the customer itself. The "foreign contents" are limited essentially to salaries and fees of the foreign specialists, which can be estimated with an appropriate precision. The bulk of the "other elements" is also either known or given, except the currency risks (ways of managing them will be analysed below).

Therefore, the main task for FTOs and their customers is to assess machinery, equipment and technology costs. This is, sometimes, more an art than science, but some model approaches exist.

To start with, every project contains some standard type of mass-produced machinery and their parts which may be checked in the relevant catalogues. The more unique or complex machinery is assessed on the basis of so-called "unit values". For example, there are some internationally acknowledged weight/output and value/output ratios for such material-intensive machinery like boilers, cranes, armatures, which can be used as price-setting yardsticks. The engines, power supply equipment and chemical apparatus also have their own value/output or value/capacity ratios such as the cost of one horsepower, one kwh of electricity, one ton of steam. What is particularly important in such assessments is to consider the "hampering coefficient", connected with the economy of scale in the unit capacity of the equipment concerned.

These "shadow" prices are only approximate, but can provide the FTO with certain objective indicators in considering offers (recommendations 6, 9).

In these negotiations, the FTO uses every opportunity to ensure the most beneficial contractual terms and conditions for the customer. The FTO strives to minimise costs without altering technical specifications and delivery schedules. The typical approaches are an optional domestic replacement of the project's "foreign content"; fixing of advantageous basis of prices of payment conditions; withstanding the supplier's overpricing bias and the enjoying all feasible ways to obtain discounts. Sometimes the customer may also agree to adjust its specifications in order to accommodate suppliers. Skillful bargaining may obtain various discounts: individual contract position, combined

(multipositions) and progressive (depending on the purchasers volume). The last two only may amount to about 10% of the initial price quoted. Possessing a well-developed transportation and insurance infrastructure, the Soviet FTOs perfer to fix their import prices on the f.o.b. basis thus saving foreign currency expenditures for the freight and insurance. At last, the contracts are safeguarded against currency risks with special gold or currency clauses. The safeguarding currency may be the one expected to be the most stable during the contract span or a "basket" of currencies, selected depending on the recent monetary situation.

Because of inflation and in the interests of the planned economy, FTOs prefer the fixed import prices without any subsequent alterations. However, because of the complexity and long-term character of some contracts, particularly on new construction, they can make exceptions, that is, prices with subsequent fixing or even "sliding prices", although with the rigid sliding limits.[1/]

In a technology transfer, price setting is more specific and based on a sharing of the economic effects among the parties arising from the exploitation of the technology depending on its rarity, patents and international experience. Payments may be arranged as lump sum, royalties per unit, price, volume of production, certain technical parameters, annual instalments or a combination thereof. The FTOs agree also to initial payments, if appropriate and deemed necessary, for the guarantee procedure selected by the parties. Any costs of the technical assistance, training and consulting are normally specified separately.

As in normal international practice, Soviet machinery import is credited on the basis of the state, bankers' or suppliers' credits or a combination thereof. This borrowing is centralised by the Bank for Foreign Trade (Vneshtorgbank) which then allocates these sums for individual agreements. Normally, the Vneshtorgbank and the FTOs prefer the terms of the state credits. However, the state funds cover usually only a fraction of the transaction and are supplemented by the credits from private sources and their consortia servicing normally up to 85-90% of the contractual price with the cash payment for the balance. Soviet debt servicing is effected as a rule by annual (semi-annual) instalments with certain grace periods after the commissioning of the equipment.

1/ To this end, the subsequently fixed price cannot be normally be 2-5% higher than the initial one. In case of the "sliding", the contracts stipulate the basic price and the structure of the alterating factors, as well as the exact methodology for such an alteration. This methodology may be, inter alia, the one suggested in the "General Conditions for the Supply of Plant and Machinery for Export" elaborated by the UN Economic Commission for Europe or be based on a shared and weighed evaluation of the various production factors (for example salary - 45%, raw materials - 40% of the costs, etc.), resulted in an alteration of the basic price in accordance with their individual dynamics. Nevertheless, even the "sliding prices" normally have their fixed limits for alteration for the contract worth as a whole (normally not more than +20%), its individual fractions (for example labour costs, metals) of the period of time (say, no alterations after six months from the signing data) etc. At last, the FTOs may use also the "mixed methodology", that is with a part of the basic price fixed and the rest of it "sliding" within certain limits.

The credits are also the normal component in the compensation agreements, when paid in kind by the products of the enterprises or in other agreed goods. The volume of back payments is specified in contracts in the quantities of products to be delivered, calculated in recent world market prices with the future adjustment to their dynamics. Payments may be accepted by the partners or by third parties including the specialised switch agencies. The contractual payments are serviced centrally through the Vneshtorgbank, which has the correspondent ties with 1658 financial institutions abroad.

2.4 Overriding Restrictive Business Practices

Even wanting access to the Soviet market and being aware of FTOs' legal and institutional positions, large Western corporations, transnationals in particular, sometimes try to impose contractual conditions unilaterally beneficial for themselves. Such restrictive business practices are seen in bidding conspiracies, refusals to deal, prescribing exclusive sources of supply, cartels, restrictions on the transfer of technology, the requesting exemptions from the Soviet law.

For example, foreign prices for equivalent Soviet machinery normally are no more than 30% higher, but some offers are 1.5 - 2 times higher than the average "price fork". Bargaining over the technical services, transnationals often try to reserve exclusive rights for subsequent service, repairs and modernisation and classify know-how. In the transfer of technology, they sometimes persist in restricting exports, volume of production, number of models, products life cycles, in paying royalties even after the expiration of patents concerned, in a unilateral transfer of improvements, in imposing minimum payments. The FTOs face sometimes the refusals to unpackage offers and demands for the partial ownership and control over the co-operation projects within the USSR.

The FTOs fight any penetration of the restrictive business practices into contractual texts. In particular, when compiling the competitive list, they cut off the bids beyond the normal ("shadow") price fork. The limits on the exports under licensing agreements are afforded as exceptions only, particularly if and when the licensor has within the markets in question the patents or other relevant industrial property rights in force, sold exclusive licenses to third parties or operate therein as the established trader himself. In the transfer of technology, the FTOs deny any limit on the volume of production, prices, minimum payments and the transfer of improvements is allowed on the mutual basis only. Meanwhile, the Soviet diplomacy actively takes part in multilateral efforts to eliminate restrictive business practices, including the elaboration within UNCTAD of a Set of Rules and an International Code of Conduct on the Transfer of Technology (see recommendation 10).

At last, it is self-evident that transnationals, pursuing restrictive business practices towards the FTOs risk undermining their business reputation in Soviet markets (see recommendations 9, 12).

CHAPTER 3: THE SOVIET EXPERIENCE AND THE SPECIFIC INTERESTS OF DEVELOPING COUNTRIES

The bargaining power of the Soviet FTOs in their relations with Western manufacturing corporations, including transnationals, is basically rooted in the very system of our economy and its modalities to govern foreign trade; in the integration within CMEA, the level of our economic development, the size of our national market, our negotiating experience. These influence both the process of bargaining and contractual terms, providing the FTOs and the domestic customers with adequate opportunities to gain access to the technological and financial potentialities of large corporations, transnationals included, and, simultaneously, to eliminate dangers.

Some of our leverages can be used only by the developed socialist economy. Others could be adapted by developing countries, especially those pursuing a planning policy and state trading.

In addition, since all flows of the contemporary international trade are intertwined, East/West trade in machinery and equipment benefits developing countries not only in legal terms and operational "software", but also as a "window" allowing them to participate particularly through the tripartite industrial co-operation.

3.1 The Soviet Experience: Cross-references to the Situations in Developing Countries

Taking into account Soviet practices, the author recommends the following:

- On the national level:

1. Unlike the USSR, no developing country can meet its machinery requirements mainly by domestic output. Sixty years ago the USSR was in no better situation than the bulk of developing countries today. This is why countries eager to become economically strong, ought to further an industrialisation, shaped by national resources and priorities. It is particularly important to choose an appropriate industrial specialisation which rationalises machinery imports and to have a local content in all imported projects. In addition to the hardware and labour, this content may also include indigenous technology and experience, industrial collaboration, and the various forms of the local participation in feasibility studies, preinvestment assessments and joint engineering (home and abroad). The further development of the tripartite co-operation also would be helpful.

2. A reliable way to achieve these goals is through import planning, preferably integrated in national planning. In our socio-economic environment, the efficiency of Soviet planning is based on the public propriety and the centralised economic management. However, an import planning may be useful even in a mixed economy, typical nowadays for the bulk of developing nations. It is instrumental in concentrating imports on the national proprieties, subjecting it to the domestic decisions and as such may be an effective arm to ensure the sovereignty over the national development. At last, the

plans as such, subject to their stability, clarity and legal and management predictability may play an advantage in bargaining with foreign corporations, particularly those having intracorporate planning.

3. This planning may be particularly successful, if it relies on the public sector, operating in foreign trade. In the USSR the foreign trade is the state monopoly and some developing countries manage it more or less in the same way. The others prefer herein a regulated private setting. However, that is of a common significance, the state should possess its own foreign trade regulations and to repulse any outside practice, hostile to or inconsistent with national goals. As an option, this state-trading may be effected through the FTOs - like commercial instruments. The individual countries may prefer various degrees of dispersing in import decisions, but it is evident that specialised organisations are the most suitable to centralise the purchases and thus to make even a small country a "bigger buyer", to prevent foreign suppliers to play domestic customers against each other, to repulse restrictive practice and thus to be a real countervailing power to the transnationals. At last, a part of the state-trading may be the network of the governmental representations abroad protecting the national interests and promoting direct contacts with the end users in a circumnavigation of the transnationals' middlemenship.

4. A part of the Soviet experience, feasible to be applied, is the diversification of the sources of machinery imports and their combining in a complementary way. The developing countries are now overdependent upon the narrow circle of the large Western corporations, originated from a few biggest Western countries. This asymetry may be corrected by an approach to the alternative sources of supply. These may be the socialist countries, the developing countries themselves, the smaller Western countries and their medium-sized business. Indeed, the USSR buys about two thirds of its machinery imports from socialist countries. The tenth five-year plan is being implemented notwithstanding a decreasing machinery import from the USA and, on the contrary, we undertake massive equipment purchases from countries like Finland, Austria, Sweden, Belgium etc., and medium-sized firms (which, as the practice has shown, are not necessarily less advanced technologically than the notorious giants) are our numerous (sub)contractors. Dealing with these more active developing countries may stimulate competition and again be the "bigger buyers" because of the smaller size of their partners and the latters' keen interests to gain orders which the giants can neglect or ignore.

5. Subjecting machinery imports to national goals depends heavily on the regulation and control of the transnationals' activity within the national territory. In the USSR transnationals are not allowed to invest domestically or penetrate planning and management. Many developing countries are more permissive, but it is worthwhile to have a representative body of the enforceable legislation (tax, company, industrial property, antitrust laws etc.) to deal with the transnationals effectively. It is no less important that this legislation is to be the sole and centrally enforceable for the whole country, regardless of its federal composition. Further on, developing countries might activate their bilatera

foreign trade instruments. Negotiating as a team, they feel themselves more strong, but bilateral contacts with Western countries may be more flexible and fruitful, the latter may result in a bilateral political or operational breakthr ugh for multilateral changes (for example, the Libyan accord with oil outsiders was the prototype for the multilateral agreement in Teheran between the OPEC and "Seven Sisters"). At last, economically, these countries might wish to use bilateral economic agreements as the arms of national planning, making the foreign trade more manageable and predictable with all aforementioned bargaining implications concerned. The bilateral pay-back deals, i.e. the marketing of natural resources contributing to an industrialisation and progressing from a simple off-setting to an industrial co-operation.

6. Many technical ways and means are available to strengthen the national bargaining power: collecting commercial information, unification of requirements for suppliers' guarantees, unpackaging, a free choice of subcontractors gaining expertise in "shadow" price-setting, the centralisation of the credit and insurance services, the governmental approval of the contractual arrangements etc.

One ought to realise, however, only relatively large developing countries can undertake national actions.

- On the regional level:

7. It is true that the USSR in its development relies widely on the socialist economic integration within the CMEA - an environment the developing countries do not possess. However, the CMEA status and practice are flexible enough to provide the interested developing countries with some "windows" to participate in certain integration schemes. Such arrangements are in force with Yugoslavia, Mexico, Iraq, Ethiopia, Laos. Since many groups of developing countries pursue their own regional integration, it is important to implement properly the numerous UN recommendations, facilitating the process of industrialisation and of the co-operation among developing countries.

8. Specifically, regional integration schemes might host such actions as regional bargaining over the common projects; unification of the commercial tax, antitrust and other laws; co-ordination of the national foreign trade planning; setting up regional FTOs as agents, serving the national interests; standardisation of the technical requirements and contractual conditions; co-ordinating the local inputs into imported projects; centralising the credit, insurance, consulting and other facilities; promoting the tripartite industrial co-operation.

9. To these ends, institutions such as the regional centres for development and transfer of technology, newly set up or being planned in Asia, Africa, Latin America and the Caribbean appear to be of a particular importance. These might concentrate their activities, inter alia, on market research, collecting and processing commercial information (including official and non-official quotations, catalogues, offers, "shadow"

calculations), negotiating expertise, elaborating model contracts and manuals, performing feasibility studies and joint engineering and consulting, the inspection and acceptance of the machinery to be imported, assisting individual countries in pre-contracting home-work, training personnel, regional technical standardisation, keeping records on the major corporations (including on the restrictive business practice), recommending reputable subcontractors, the sources for imports diversification etc. This can be more or less easily done, since the exact functions of these centres are still under consideration.

Nevertheless, these are some issues which need rather broad international actions, including those in the framework of the recent restructuring international economic relations on a fair and democratic basis and initiated and implemented by international institutions concerned, such as UNIDO.

- The international level and the UNIDO domain

10. First of all, it is of primary importance to elaborate more rapidly within the UN machinery documents as an International Code of Conduct for the Transfer of Technology, a Code of Conduct for Transnational Corporations and a Set of Rules on Restrictive Business Practices, which can offer the developing countries ways to strengthen their individual and collective bargaining positions and to counter restrictive business practices.

11. To this end, UNIDO might increase its participation in their elaborations, suggesting the specific terms and regulations to be embodied in these documents. Such action could ensure, first of all, an integral intertwining between the eventual International Development Law and these very instruments. The above mentioned codes by their legal nature ought to be stronger than ordinary UN resolutions and to rely in their implementation on both the machinery of individual member states and an international setting, provided by the existing UN structure. The specific UNIDO contributions to these documents might be formulated on the basis of a questionnaire to be sent to member states or through other appropriate consultation procedures as that has been already done, for example, by the ILO.[1/]

12. At last, independently and at its own, UNIDO, as the UN body in charge of the industrial development, might undertake such pioneering initiatives as establishing a data bank for the collection of relevant information on prices, quotations, offers, contractual conditions, pertaining to the machinery trade; elaborating a set of model contracts with particular emphasis on the specific problems of developing countries; gathering appropriate information and methodology on the negotiating technique, "shadow" price-selling, "self-packaging" offers, suppliers guarantees and the procedure for their implementation;

1/ For example, UNIDO thoughts on the suppliers' guarantees might be taken into account in chapter V of a Code of Conduct on the Transfer of Technology, on an unpackaging - in chapter IV of this Code and Section C of the Code of Conduct on Transnationals etc. The next sessions of the UN bodies dealing with these Codes will take place in October 1979, that is after the Third General Conference, which may thus wish to authorise the appropriate steps of the Secretariat.

recording the restrictive business practices: keeping files on the "behaviour towards development" on major corporations: setting a reference service on the alternative sources of the machinery imports, subcontracting, opportunities for industrial co-operation, including trilateral ones, as well as on the existing and newly-emerging abilities of the individual developing countries to provide the material and intellectual inputs for the industrial projects within and outside the Third World. UNIDO might also undertake to adapt the manuals used in the East/West trade in machinery to the specific needs of developing countries. Through in-house consultations and negotiations (on a universal basis or among interested countries) all these may lead to formulating internationally acknowledged norms and models or even to law-making actions. To this end, a co-operation with other UN bodies and regional organisations seems to be essential.

3.2 Some Practical Implications and Opportunities

Meanwhile, the management of the Soviet machinery import from the West is not only an abstract model for developing countries. In many aspects, it also provides developing countries with tangible opportunities to expand their own exports, to further industrialisation, and to strengthen their bargaining powers vis-à-vis the Western corporations, including transnationals.

First, some Soviet machinery imports are used in enterprises, which process goods imported from developing countries and thus augment the Soviet internal demand for their products. Similarly, some imports are applied to Soviet export enterprises, thereby expanding our abilities to offer a wider range of the competitive products and technical assistance to developing countries. For example, Western machinery was partly used to equip two factories in Kuibyshev and at Trostianez, producing chocolates from imported cocoa-beans. FTO "Techmashexport" sells to these countries the power supply equipment, assembled with some elements subdelivered by Swedish "ASEA" and Finnish "Kontram".

Such practices give developing countries alternative sources of machinery supply, diminishing their one-sided dependence on Western markets and transnationals.

The positive implications of Soviet machinery import from the West for developing countries manifest themselves also through development assistance. Its further increment is relying, to a large extent, on the Soviet export sector, absorbing Western machinery as well. Moreover, there is a growing practice of joint construction of the industrial and other enterprises in developing countries, when the Soviet FTOs, playing the general contractors, obtain a part of the equipment and technology concerned from Western subcontractors or vice versa. As an illustration, FTO "Tsvetmetpromexport" being the general contractor for the pipelines network to be laid down in Nigeria, has engaged a British firm as a consultant and announced tender for subdelivering pumps, bidded by West German, Italian, Belgian and French interests (see recommendations 7, 8).

What is most remarkable, however, is, while acting as general contractors in developing countries, FTOs usually invite, as their subcontractors, not only foreign, but also domestic business, thus converting the projects concerned into the tripartite industrial co-operation. For example, FTO "Tsvetmetpromexport" in Nigeria awarded local firms contracts for preparing the construction site and clearing jungles. Similarly, these subcontracts sometimes are distributed among other developing countries. When erecting the steel mill in Nigeria, FTO "Tjazproexport" awarded significant subcontracts to an Indian heavy machinery plant in Ranchi. All these enable developing countries to expand their indigenous technological and industrial capacities, to increase employment and export, to gain expertise in the foreign bidding, construction and in the international competition.

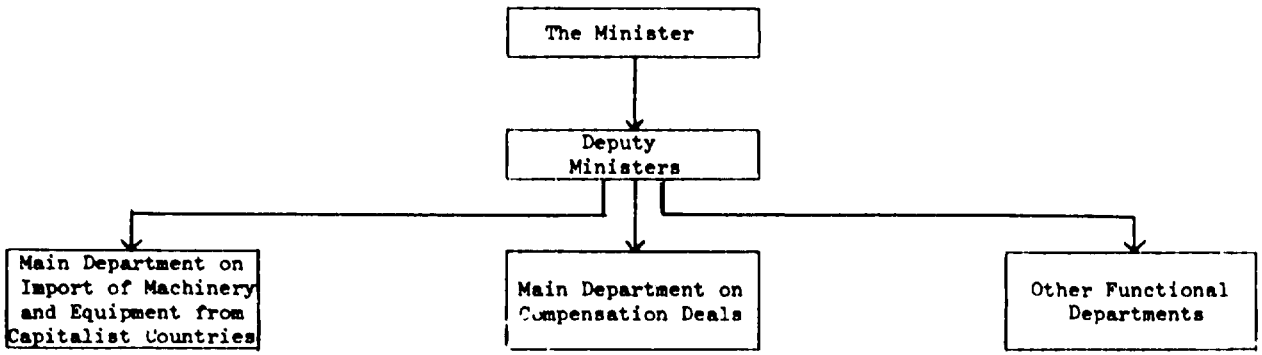
The Soviet Government actively puts forward the offers for tripartite co-operation in the long-term agreements and programmes with Western countries and within the framework of the mixed intergovernmental commissions, supervising these. The options to co-operate in third markets are now embodied in these programmes and agreements between the USSR and Austria, the United Kingdom, Finland, France, the FRG. The problems of the tripartite co-operation have recently been under discussion during annual meetings of the Soviet/Finnish and Soviet/Austrian mixed intergovernmental commissions. There is a growing interest in it among developing countries. The Soviet/Indian long-term programme for co-operation, signed in March 1979 formalised many of these practices, stipulating joint actions of the Soviet and Indian enterprises on the third markets.

These implications and opportunities help restructure the international economic relations on a fair and democratic basis. For example, the tripartite co-operation allows more favourable contractual conditions for machinery acquisitions than a direct import from the West. For example, through the Soviet general contractors, Iraq has managed to obtain Western technology for a development of North Rumeila oilfields, refused assistance by the "Seven Sisters" after nationalisation. The joint bidding by the FTOs "Tjazpromexport" and the Finnish "Rautaruukki" for the order of blast furnaces shop in Venezuela helped to increase competition between the bidders. Moreover, the enterprises being constructed trilaterally, are placed under ownership and control of the host developing country and are not subject to unreasonable restrictions including export and transfer of technology.

In sum, the experience gained by the USSR in the machinery import from the West may be of use and of interest to developing countries both in its legal, institutional and contractual setting and through the practical business opportunities and arrangements, conducive to development.

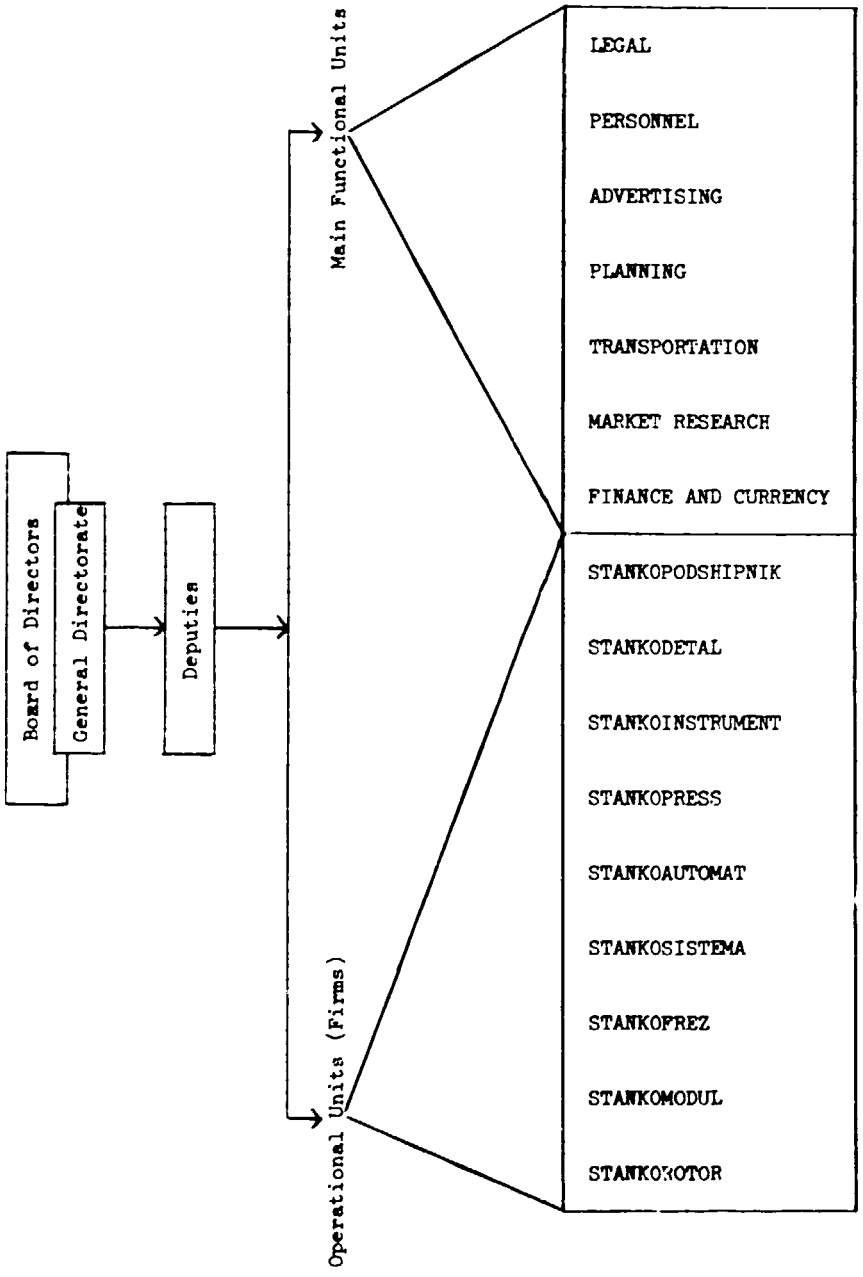
CHART 1: THE STRUCTURE OF THE MINISTRY OF FOREIGN TRADE

(The Segment, Dealing with Machinery Imports from the West)



AUTOEXPORT	AUTOPROMIMPORT	ELECTRONMRGTECHNIKA	LICENSINGTORG	MACHINOIMPORT	MASHPROBORNITORG	METALLURGIMPORT	PROMMASHIMPORT	STANKOIMPORT	SUDOIMPORT	TECHMASHIMPORT	TECHNOPROMIMPORT	TRACTOROEXPORT	VNESHSTROJIMPORT

CHART 2: THE STRUCTURE OF THE FTO "STANKOIMPORT"



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FUNDING SUPPORT FOR "SELECTIVE ACCESS" POLICIES:

Methods and Mechanisms to Create a Better Community of Interest in International Industrial Co-operation .

by

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CHAPTER 1: PRESENT TRENDS OF FUNDING INVESTMENT IN DEVELOPING COUNTRIES

General Developments of Equity Finance.

The basic patterns of private foreign direct investment development as outlined above bear out the slow growth of private foreign direct investment in developing countries. In addition, what little growth exists is very unevenly distributed. A number of developing countries have sometimes been cut off from industrial investment funding flows. Others cannot rely on a steady volume of funds needed for further industrialisation. The reasons for the small contributions of private investors from industrialised countries are twofold:

Firstly, private enterprises in industrialised countries have undergone significant changes in the degree of self-financing. Self-financing or internally-generated capital, sometimes supplemented by additional capital contributions of share holders, is the basic layer of capital for investment purposes. The degree of self-financing together with the structure of external capital determines the propensity of an enterprise or an investor to embark on risky strategies. The more equity capital, as a result of self-financing, the enterprise can rely on the less it is subject to adverse effects of fluctuations of business. As self-financing is gradually diminishing in many industrialised countries, new risky investments will decrease.

Secondly, private direct foreign investment in developing countries has been perceived by investors from industrialised countries as a risky operation. It is evidenced by the higher risk premiums demanded by investors. One of the risk factors is the so-called "political" risk, involved in investments in developing countries. But other trading or commercial risks are also presumed to be substantively higher in these countries.

Taken together, funds for investment in developing countries will have to consist of internally generated or other high-risk funds. As long as the risks attached to investment in developing countries are evaluated to be high, other funds, less risk prone, may not be used to supply investment capital. Consequently, funding in the medium term will be very limited.

CHAPTER 2: GUIDELINES FOR NEW MECHANISMS

1. The Issue for New Mechanisms.

To remedy the funding situation briefly outlined above and in pursuance of the mandate and the policy objectives raised therein, two routes of action may be proposed:

First, risks attached to private foreign direct investment may be reduced. It is important to realise that funding of investment, either by investors or by lenders critically depends on the measure of risk involved in the transaction. Since the role

of investors as principle risk takers in the supply of finance is gradually reduced in relative importance, the risk involved in funding will be even larger. Mechanisms have to counteract this development by offering some features of risk reduction.

Secondly, the risks of investment have to be assessed and matched with appropriate suppliers of funds in order to create an optimal mix of project's funds and risk expectation of funding sources.[1/]

Both measures will eventually lead to an increased availability of funds, as reduced risks, given a constant return, may stimulate additional sources of capital. Sources such as commercial banks which are not usually suppliers of risk capital, may be more willing to commit funds if reduced, i.e. "bankable", risks are apparent. But their risk-taking capacity is limited to the default risk, i.e. the risk not to recover outstanding amounts from borrowers. Default risks in turn may fluctuate according to the amount of project's risks occuring during the life of a loan. Therefore, default risks are subject to the overall risk distribution of a project. If the general risk incidence can be reduced, the default risk will be accordingly lower permitting other sources to extend capital to projects.

2. Risk Transformation as the Common Denominator for Mechanisms.

The activity to be shown by new mechanisms, the reduction of risks[2/] and the possibility of new funding sources may be called risk transformation. The process of risk transformation begins with two basic assumptions:

The first assumption is that sources have a certain degree of risk aversion. They will advance capital to projects only in cases where the risks for an adequate return do not exceed this level. The level of risks acceptable to sources depends on two factors.

- the ability to handle or manage the risks attached to the funding operations and

- the ability to accommodate losses on risky assets.

As demonstrated by the funding patterns of different parts of the investment cycle, the degree of riskiness of various operations can be measured and may be perceived by the source.

The goal of risk transformation then is to make risks involved in projects and sources risk expectation compatible.

1/ Risks are measured in various ways, e.g. in setting risk premiums for returns on capital or making provisions for losses.

2/ Risk is defined as the negative deviation of an expected return. The smaller value of returns may be caused by technical, financial or managerial problems in all stages of project planning and implementation.

3. Alternative Ways of Risk Transformation.

There are basically two ways to transform risks. The "upstream" transformation alternative is to reduce risks by controlling the occurrence. This has traditionally been the task of investors for the so-called trading or commercial risks. "Downstream" transformation reflects the way insurance and lenders are handling risks. In essence, it implies the insertion of risks in a broad portfolio of equal risks. The greater the number of risks a portfolio covers and the more homogenous these risks are the better are the chances of calculating reserve requirements for losses. By charging costs to capital, allowing for reserves, risks can be perfectly accommodated.

In addition, funding risks may be diversified. Diversification rests on the theory that independent cash flows as the financial stratum of an investment project will not cumulate their respective risks. Rather they will, on the average, balance out each other's risks. Well diversified stakes in a number of projects may increase the capacity to accommodate more projects with possibly higher risks.

Both "upstream" and "downstream" transformation may be achieved by three methods. Shifting risks is effectuated either by assigning the task of control to somebody particularly capable to manage risks or by having recourse to an institution different from the project's owner or investor in case of loss.

Spreading the risk involves increasing the number of participants sharing in the control or assuming a part of the burden should a loss occur. Securing risks is an option ordinarily open only to downstream transformation. It means the setting aside of assets to be liquidated in cases of loss. Upsteam securing can be achieved by restricting particular strategies which may be deemed to pose unbearable risks.

4. Means of Risk Control

Because downstream risk tranformation is a feature commonly practised by banks and insurance companies, it needs little explanation; but the ways and means to achieve "upsteam" transformation have not often been explored. Generally, it has been the investor entrusted with the goals of proper management of the project's funds who was responsible for control. Other sources of funds perceived him as the party responsible for paying claims if risks were not avoided. The developing economy has had to take the lion's share of losses because the investors have hardly been in a position to control some of the external factors influencing project risks. Accordingly, investors have refused to take these risks or charged high premiums, which in turn reduced the attractiveness of a project to the developing countries. As a consequence, other measures are called for to at least attempt control.

One possibility[1/] of risk spreading is the externalisation of price and marketing risks. Long term purchase contracts with fixed or regulated prices can assure this aim. Another possibility of risk spreading is to create infrastructure which can support a project in cases of severe strain. By carefully tailoring the project to the facilities and/or creating infrastructure responsive to project's needs, risks can be carried by an economic environment supporting the project. This would also help to reduce frictions with politically motivated, i.e. not directly market oriented, bodies of the developing economy.

Risk shifting has been practised by financial institutions and banks as well as other institutional investors. One mechanism used rather broadly consists of involving home state or host state authorities in projects, to induce these bodies to influence projects' risk. As a rule host states have granted guarantees for the risks under their control.

Finally, to hedge against project risk, lending institutions have often resorted to lending control measures. This has been achieved by provisions, stipulated in loan agreements, setting indicators as to the project's health. If these indicators, e.g. certain financial and related standards, signalled a risky situation, banks attampted to use their influence on their customers to cure the situations.

5. Conclusion

Risk transformation as guidelines for mechanisms to be proposed have to perform two functions: First, they have to assess and evaluate risk and subsequently shift identified risks to institutions which are best suited either to control or to accommodate them in their portfolio. Secondly, project risks not manageable this way have to be reduced by spreading or securing to such an extent that appropriate fund sources may be willing to supply capital. Both fit together with the questions raised in the preceding chapter. Both risk shifting and risk control may increase capital flows or at least help to bring about more stable funding conditions. Developing countries participating in risk control may thereby decisively increase their share of influence over funding conditions. In fact, the more risks are reduced by a control acceptable to funding sources, the more stable the funding flows will be.

1/ Most of the measures of risk and its control are dealt with in the chapter on finance. These measures generally aimed at spreading risk over a large number of institutional investors, do not touch on the control aspect advanced here.

CHAPTER 3: "CONCEPTUAL FRAMEWORK"

International industrial co-operation does not solely consist of a transfer of funds across borders. Rather it has to be considered as a bundle of transfers of tangibles and intangibles allowing the investor to achieve his business goals. Still, the availability of funds for investment plays a dominant role in the decision process leading to the establishment of a project. It may not only decide whether or not to invest. It will also substantially influence the goals of investment, its execution and performance. The scarcer the funds, the more their influence on investment.

For this reason, it appears indispensable to back up "selective access" policies through mechanisms, providing funds on terms compatible to overall policies of international industrial co-operation. In fact, funding has to be among the policy options pursued to promote performance and stability. Objectives for funding devices are, therefore, in no way different from other methods advanced and explained in this chapter. They necessarily supplement contractual and legal improvements in the co-operation process.

The system proposed is neither meant to be exclusive nor a substitution for the well-functioning traditional machinery of export and investment funding. It attempts to create instruments to cope with an industrial co-operation situation characterised by emerging forms of co-operation. These instruments can be used by existing bodies active in channeling funds to projects.

The instruments are:

(1) Industrial Investment Insurance Corporations. Such corporations should be established in each major region of the Third World by countries of the region, and insure investments made among these countries (South-South), against political risks.

(2) Investment Insurance System (a forum for the regional investment insurance corporations and insurance institutions of industrialised countries). The system should aim at harmonising investment conditions (avoid overlaps and distortions).

(3) Regional (developing countries) guarantee for industry (industrial investment) association (covering project related loans against commercial risks). Would transform non-equity funding into long-term risk capital.

(4) Contractual (contingent) liability insurance consortium (covers failure to perform according to contract). Applies to package purchases of whole industrial complexes.

The consortium should enable foreign contractors to undertake high risk projects with possibly costly performance requirements.

CHAPTER 4: INVESTMENT INSURANCE

1. Former Proposals

Proposals of promotional mechanisms for foreign investment frequently have been the centre of international attention. They may be grouped roughly under three headings:

- creation of a multilateral investment insurance agency. By insuring foreign investment in DCs against political risks reserve requirements or write-offs for losses on investment can be reduced. Hence, the investor may increase foreign holdings without a parallel increase in domestic reserves;
- strengthening of the funding base of multilateral financial agencies to increase direct funding for projects in DCs. More recently, third-party financing as an approach to create a better balance between the investor and the DC has been advocated;
- reactivating or creating multilateral financing guarantees granted by international bodies. Guarantees may be extended on a more informal basis demonstrated by the so-called co-financing technique or as a straightforward guarantee for loans or bond issues.

All of the many proposals forwarded have to compete with bilateral proposals and schemes, existing or planned. In this area, competing ICs' export financing schemes - direct lending, subsidies or guarantees - have remained one of the most efficient direct or indirect suppliers of investment capital especially for manufacturing investment. Bilateral investment promotion or guarantee treaties have set mutually acceptable norms of behaviour for foreign investors. In exchange, national investment insurance is granted to investors subscribing to these norms. Each of the three groups of proposals has its merits. However, it is suggested that none of the proposals be actively promoted at this point. All proposals have been built on the understanding that increasing the fund flow is in itself an aim worth being supported. Therefore, these proposals aim gradually to increase investment funds channelled to developing countries. Consequently a step-by-step improvement of the institutions already in existence may lead to a better performance over time. Co-financing, for instance, is a technique which has to be developed little by little. It has to allow for a process of building confidence among the responsible actors in this field. Any new mechanisms will only interrupt this process and adversely affect the performance of this technique. The same reasoning applied to an increase in investment funds channelled through direct project-lending operations of international financial institutions. Whether these institutions should search more aggressively for new projects to be financed under established rules or should relax some project examination rules may be decided only on a case-by-case basis, eventually leading to a new state of the art.

Proposals for mechanisms offered in this paper start with the understanding that structural changes in the funding process may only be brought about by a new institutional set-up: the structural changes to be pursued have been broadly stated in the first chapter of the study. They may be briefly restated as follows:

Foreign investment should be activated along the lines of mutual long-term benefits. To reap these benefits, development performance has to be increased in line with DC policies. In exchange, problems relating to long-term stability of investment, which have in the past contributed to higher cost for investment in DCs, may be satisfactorily solved.

The same principles apply to the question of adequate funding for investment in DCs. Funding will ultimately rely on repayment security. Stable repayment conditions depend on performance of the project, i.e. the contribution of the investment to the developing economy.

Given the necessity for DCs to determine their goals of performance for investment, funding schemes will hinge on a clear-cut proposition: funds on appropriate terms will be available on condition that these funds promote investment in line with DCs' "selective access" policies[1/]. Funding support mechanisms will, therefore, have to incorporate these selective access and control policies in a balanced way, in order to increase stability and subsequently the probability of an increased flow of funds.

Mechanisms proposed share three traits: first, the decision to support funding is taken from the DCs' viewpoint of investment. The funds' uses and effect on performance are the benchmark for a positive decision. Second, the mechanisms have to reflect DCs' determination to create a self-sustaining process of industrial development. Mechanisms are, therefore, designed to be self-reliant. Third, co-operation between DCs and ICs is achieved on a concrete project basis. In this way a coincidence of interest may easier be determined and sustained for the life of the project.

2. Multilateral Investment Insurance and its Shortfalls

To illustrate the approach followed by this paper and to indicate changes vis-à-vis former attempts, proposals for a multilateral investment insurance scheme have received increasing attention[2/]. Proposed schemes protect foreign investment capital, inclusive of retained earnings and in some cases long-term loans in lieu of investment, against the risks of war, internal unrest, expropriation and inconvertibility or transfer difficulties. Risks of this kind are termed "political" risks.

1/ For a definition of this principle, see Ch. 3.

2/ The interest has been reignited by the Sri Lanka proposal for Third World participation in investment insurance schemes, made at the 33rd UN General Assembly 1977.

Proposals for international investment insurance have had a lengthy history. Even before first models of an International Insurance Agency (IIIA) surfaced in 1962, efforts had been undertaken to create multilateral insurance for the risks mentioned. The last and most widely publicised attempts, the IIIA, was put to rest in 1973 when agreement could not be reached on a substantial number of issues[1/].

Three basic arguments for a dismissal of such insurance are:

(i) schemes of the kind proposed have limited influence on the propensity to invest in DCs;

(ii) no lasting global interest exists to support operations of a multilateral scheme;

(iii) there is no need for a new North/South scheme as existing national schemes can fulfil its aims more efficiently[2/].

Limited evidence concerning point (i) indicates that investment insurance alone will not contribute decisively to more and better adapted investment in DCs. A prime reason is transactional cost, especially for medium and small investors, in arranging insurance with such an agency. However, it is these investors the agency should be addressing in the first place.

In regards to point (ii), discussions on IIIA have demonstrated clearly that no lasting global interest for internationally insuring of investment can be achieved. But even if an agreement could be reached, international rules cannot take into account demands of individual DCs' policies in relation to insuring foreign investment. Secondly, global control over investment has to be exercised to keep risks at an acceptable level. But the rules for control necessarily will be far too general and, in any case, insufficient as a basis for operative, rational insurance policy. Thirdly, subrogation and dispute settlement will always create frictions between members of the scheme. These frictions, which will be felt also by the governing body of an insurance scheme,[3/] will have a direct impact on future funding. The governing bodies may also be hampered in fulfilling other duties and services by their role in the administration of insurance.

In considering point (iii), no apparent need can be seen for such a scheme. During the last decades, a number of national schemes in industrialised and middle income countries have been established. These schemes because of their small size, compared to an

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1/ For a general survey of problems and approaches see Martin, Multilateral Investment Insurance, Harvard International Law Journal 8 (1967) 280;

2/ Some of the objections voiced in this chapter have also been made in a paper by the Development Committee, Multilateral Investment Insurance, The Harmonisation Alternative, DC/WG/CM/78-3, 7 September, 16 February 1978 and preceding papers of the same committee.

3/ Cf. especially for conflicts of interests arising out of such an activity for international bodies Aron Broches, International Investment Guarantees, Proc. Am. Soc. Int. L. 1962, 81, 87.

international scheme, and their ensuing capacity to react quickly to changes, are in a better position to accommodate new patterns of investment. Most of the states supporting such schemes would be rather reluctant to abandon their schemes or transfer part of their resources to an international agency. Other schemes considered insurance enough of an incentive to make investors follow a mutually accepted code of conduct[1/]. Whatever the efficiency of such insurance, DCs will gain only if the code reflects "selective access" and control policies. As these factors may change from time to time, the stability required by such a scheme may be questionable.

Another noteworthy attempt as presented by IADB would consist of an insurance system exclusively geared towards extractive industries. In this limited sector with its particular risk features, mutual consent for stable operations probably exists.

In conclusion, mechanisms substituted for past futile efforts should consider policy options of DCs and vested interests of ICs or DCs. As both these areas of interest differ widely, an attempt has been made to create an organisation taking into account these differences.

3. A Two-Step Investment Insurance

The sheme proposed here consists of two parts: 1) Industrial Investment Insurance Corporations (IIIC) on a regional level, as institutions to insure DC investors against traditional risks of investment within the region; 2) an Industrial Insurance System (IIS) as a forum to help settle colliding interests of IIICs and to create a forum to exchange views with insurance schemes of ICs. In this way two of the above objections are achieved. New mechanisms should not be directed towards big enterprises from the North, where the incentive effect is minimal. And, while no balance of interest can actually be found to exist between ICs' insurance and DCs' policies, DC demands may be voiced more efficiently in a system combining countries and institutions from the South and the North.

a) Industrial Investment Insurance Corporation (IIIC)

IIIC's regional insurance corporations to assist in and promote intra-regional development among countries from the South may be shaped along the lines of the Inter Arab Investment Guarantee Corporation (IAIGC). This corporation, actually the only one in existence, has been active since 1975[2/]. For a more precise description of its organisation and its function as a model for other IIICs, the reader may refer directly to the Convention establishing IAIGC and other legal instruments. Some topics are highlighted here in order to supply background for this discussion:

1/ See e.g. Commission of the European Communities, Need for Community Action to Encourage European Investment in Developing Countries and Guidelines for Such Action, COM (78) 23 final, Brussels, 30 January 1978.

2/ The author gratefully acknowledges material provided by the Director General of the IAIGC Mahmoun Ibrahim Hasan as well as other information supplied on occasion of the Meeting of Financial Experts held in Vienna from 6 to 8 December 1978.

The aims of the corporations are to improve the investment climate within the region in order to spur intra-regional investors' willingness to invest across borders. The basic instrument to induce this behaviour is investment insurance granted to investors against political risks. Insurance is granted to increase intra-regional co-operation and to promote effective development in cases which would otherwise not have been viable, (art. 2 and 16, para 1 (a) and (b)).

The corporate statute envisages the funds to be partly paid in and partly callable. For economically weaker countries provisions have been inserted to allow for soft-currency financing of the shares. In cases of loss, member countries' liabilities are limited by their shareholdings. All rights against the insured party, including rights held by the host member country, will be subrogated to the corporation. The law would encourage contracting states to improve the regional investment climate and to induce harmonised investment conditions. Principles of law common to all contracting states, i.e. not just the legal provisions in force in home and host states, shall govern as long as there is no explicit provision of the convention.

b) Investment Insurance System

IIICs set up according to the model on a regional basis will in turn be members of the Investment Insurance System, as will IC national investment insurance schemes. IIS is, however, not intended to be another guaranteeing body. Rather its aim is to be a forum for conflicting interests of institutions dealing with the same subject, investment insurance. In principal, actions to be taken by IIS are recommendations, which upon adoption by a system member may result in a better adjusted practice of investment insurance. There are two distinct areas for recommendations.

(i) Recommendations may lead to an improved co-operation between different insurance schemes;

(ii) recommendations may cause conditions of insurance to reflect better the prevailing prerequisites of development.

As to (i), it may be envisaged that IIS's recommendation will make it easier for members to co-operate and to harmonize their rules for the extension of insurance as well as for purposes of loss administration.

As to (ii), a gradual adjustment of conditions granted for insurance in recipient countries may lead to a greater responsiveness of investment insurance for projects' needs.

These mechanisms and ICs' investment insurance programmes are planned to comply with the basic quid-pro-quo requirement. No immediate instrument to create the balance of interests can be suggested at this stage. But it is IIS which gradually will, by confronting ICs' investment insurance with IIICs, create enough momentum to secure stable investment conditions in exchange for increased developmental performance.

CHAPTER 5: GUARANTEES AND INSURANCE AGAINST COMMERCIAL RISKS

The regional guarantee scheme proposed particularly should help minority and non-equity investments to overcome funding constraints due to the absence of a provider of risk capital. The insurance scheme mainly concerns foreign contractors, i.e. contributors of assets, who increasingly are called to furnish all equipment and intangibles for production. The essential difference between the guarantee scheme and the regional insurance scheme lies in their respective approach to changing structures of investment. The guarantee scheme's raison d'être is the substitution of equity-funds by external funds secured by the guarantee of the projects' major beneficiaries in order to create a working identity between risk control facilities and the locus of risk within an investment project. The regional insurance scheme should enable foreign contractors to assume risks that they are best suited to control. In addition, as new and bigger risks of contracts exceed the risk-taking capacity of contractors, the regional insurance scheme will provide an opportunity to guarantee that damages caused by risks will not endanger the viability and performance of a project.

As they are closely related in principle, the operations of both mechanisms may be complementary. Basically, the guarantee scheme secures repayment of funds, regardless of the risks threatening to interfere with repayment. The regional insurance scheme secures the termination of a project in the agreed-upon manner: either by insuring particular risks or by insuring contractual behaviour of the contractors. As bringing the project into production in an orderly manner is one of the foremost prerequisites of loan service, they help to increase the probability of repayment.

CHAPTER 6: REGINA: GUARANTEE FOR FUNDS - REgional Guarantee for INdustry Association

1. Introduction

Contrary to investment insurance, which has a settled insurance pattern and practice, other funding support mechanisms have to take into account different states of project funding and different types of projects to be promoted. Therefore, they must be organised to allow for additional flexibility. In REGINA, the mechanism proposed in response to the present funding situation, guarantees supplied by developing countries, members of the association and industrialised countries are to be channeled through a regional association. The guarantees against non-political, i.e. commercial or trading, risk in member countries, are given in the form of investment and contractual contributions to otherwise financially unviable projects with a positive developmental effect.

a) Some Requirements for an Additional Institution.

Before detailing the reasons leading to REGINA, three preliminary points have to be made:

(i) REGINA is supposed to serve as a more effective intermediary for medium-sized projects on a regional basis;

(ii) REGINA has been proposed to fill existing lacunae in presently operating funding systems;

(iii) REGINA is a self-help institution. Its operations should be economically viable and even self supporting.

As to (i):

At present, the general situation for project finance is characterised by an abundance of funds vis-à-vis an apparent scarcity of "viable" projects[1/]. This imbalance can be attributed to:

- the existence of a highly centralised, concentrated structure of financial institutions channeling funds to developing countries' projects[2/];
- an insufficiently developed network of institutions capable of identifying small and medium-sized project opportunities and matching these opportunities with adequate sources of capital[3/] within a given region.

In this respect REGINA's aim is twofold:

- It has to identify and prepare projects opportunities or increase the absorptive capacity of projects for external funds:
- it has to bridge the gap between higher level insitutional sources for development funds and the projects.

As to (ii):

As far as the guarantee facilities administered by REGINA are concerned, REGINA has to react to emerging patterns of investment in developing countries. Most of the guarantee and support schemes of industrialised countries have been shaped according to the internal political considerations of industrialised countries. Examples are

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1/ Discussions on the Expert Group Meeting on Industrial Financing, Vienna, 6 - 8 December 1978, ID/WG.287/10, 22 January 1979, sec. 15.

2/ IBRD, World Development Report, 1978, p. 67.

3/ More common explanation is the low absorptive capacity for funds in developing countries. This argument may be valid for general purpose lending. The absorptive capacity for project funds, however, is determined to a large extent by the behaviour of funding sources and by the availability of identified funding opportunities.

export credit guarantee or insurance schemes. Their operations are not primarily intended to help fund developing countries' projects, but to increase the export of capital goods. The same holds true for investment insurance[1/]. Its purpose is not so much the facilitation of investment as a contribution to developing countries' economies. They are rather thought to help overcome investors' difficulties in conquering new markets. Consequently, the requirments for support from these sources only secondarily reflect developing countries' policies toward investment. The resulting lacunae include:

- guarantees or insurance for multinational ventures;
- transfer of intangibles in lieu of investment;
- minority investment.

If need arises in industrialised countries, these lacunae may be eliminated by various other devices. Indicative are guarantees for service for the mineral extractive industries or schemes to cover foreign currency costs or finance of a guaranteed export contract[2/]. Still, an institution whose decision making is dominated by the developing countries receiving the transfer will be in a better position to phrase its conditions of operations according to policies represented by developing countries.

As to (iii):

To safeguard the DCs' decision-making authority, REGINA has to be designed and run as an economically viable self-supporting institution. Therefore, care has been taken to:

- allow for flexible reactions to socio-economic prerogatives;
- adhere to established organisational schemes which have proved their economic viability;
- create REGINA as an institution which should perform more efficiently than previous attempts.

b) The Issue of Guarantees

Guarantees by REGINA will be particularly suited to achieve effective risk-transformation. First, transformation is secured by the shifting of some project risks to industrialised countries and developing countries. Upstream transformation

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1/ This paper follows the definition of the terms "insurance" and "guarantees" as developed e.g. in the Development Committee, Multilateral Investment Insurance - The Harmonisation Alternative, DC/WG/CM 78-3, Sup. 7, 16 February 1978. Nevertheless the distinction appears to be rather arbitrary.

2/ See the OPIC insurance programme or the guarantees given by Treuarbeit and the Scheme proposed by ECGD, whereby ECGD insures project finance by Eurobanks, see R.D.C. McAlpine, The Financing of Capital Projects, a View from London, The Banker, December 1977, 63 (69).

by securing risks is exercised by the control of REGINA over guaranteed projects. Project control is facilitated as

- REGINA acts on a primary level and in co-operation with the most important factors of industrialisation of the project's home country;
- REGINA is to develop the abilities to evaluate the projects in their proper social and economic environment;
- REGINA acts in harmony with policy conditions applicable to projects thus preempting possible political frictions.

In addition, granting guarantees will better match project opportunities to funds as guarantees may:

- act as a catalyst of other funds, which would not have been available without the guarantee covering default risks;
- influence the perception of risk of other, mainly unsecured, lenders involved in lending to the project;
- thus help reduce cost of original lending, possibly resulting in a final cost advantage for borrowers[1/];
- exert pressure on project owners to tailor their projects to fit requirements for guarantee programmes as well as to stay by accepted standards of project management and performance[2/].

By concentrating on guarantee operations, REGINA may attain a high standard of proficiency which comparable direct-lending operations ordinarily may not have.

First, REGINA could restrict its efforts to controling and monitoring projects. As guarantees are granted by other institutions, REGINA would not have to divide its resources between the management of portfolio and the monitoring of debtors.

Secondly, by specialising in project evaluation and control, REGINA may gain economies resulting in cost advantages over comparable lending operations.

In essence, REGINA will be asked to assume part of the traditional investor's risk-control functions. Once REGINA has managed to identify risk, to shift or spread it, it will have to arrange that remaining risk be kept at an acceptable level. If contributors know the risk limitations, projects may be as attractive as other ventures.

1/ See Development Committee, op.cit., p. 78.

2/ Guarantee systems might by their mere existence stimulate new and better project proposals, as project promoters will be encouraged to ensure that they qualify for the guarantee scheme, cf. Report on an UNIDO Expert Group Meeting on Industrial Co-operation Contracts and Procedures for Solving Differences, Vienna, 16 - 24 November, 1977, ICIS.61, 3 April 1978, p. 13.

2. Basic Features Common to all of REGINA's Operations

Three areas presumed to be in REGINA's domaine are detailed below:

a) Regional co-operation

REGINA should operate on a regional level, "region" being defined as a number of adjacent developing countries sharing a development standard and a level of industrialisation which make their policy objectives amenable to some harmonisation. This, in turn, will induce the lowering of barriers to inter-country exchanges and will provide opportunities for projects, operating on a regional level[1/]. Similarly, conditions for funding will have to be harmonised to such an extent that foreign contributors perceive the various countries as one region. Although some regional institutions have experienced periods of strain[2/], they appear to fill a gap, characterised by the lack of small flexible institutions, not directly subject to the vagaries of political change in a single country, but big enough to undertake projects to serve a larger market.

b) Guarantees

REGINA will administer a guarantee scheme. This will permit developing countries to use and develop financial experience without being forced to supply the major funding required at the outset of banking operations. Reserves for losses have to be established, but they can be kept low if REGINA succeeds in drawing on qualified personnel[3/]. It is hoped that, given REGINA's skill, liabilities for guarantees need not be considered as actual claims against assets of the institution. Although such a practice might avoid conflict over the attribution of losses to shareholders, but close control and supervision of risks should keep contingent funds at a reasonable level as the probability of losses decreases.

c) Membership

REGINA will not extend guarantees on its own account. The institution is intended to serve as a broker for guarantees of industrialised countries and a trustee-fiduciary for developing countries' guarantees. Three different groups of participants of equal standing but distinct qualities should participate in the management of REGINA:

- member states' industrial planning authorities would represent the policies of the members:

1/ This has been the explicit aim of organisations like CAF or the AIF.

2/ A prominent example is the EADB. Its operations geared basically towards integration suffered through political dissonances between member countries, see O. Eze, The Legal Status of Foreign Investment in the East African Common Market, 1975, p. 63 passim.

3/ e.g. EXIM-Bank (US) has a 25% reserve requirement for guarantee operations.

- manufacturers' associations would supply technical know how in considering the feasibility of projects under the conditions in the industries involved;
- development banks would contribute experience in financial evaluation and funding of projects.

The three groups should manage to combine their resources to reach balanced decisions. Co-operation procedures will have to be carefully drafted to prevent disfunctional behaviour of any one of the groups. All three would be able to benefit from balanced operations:

- member governments would have an effective instrument to enforce investment policies;
- manufacturers would gain access to guarantees and funds with better conditions;
- development banks would find funding outlets.

Foreign institutions and governments extending guarantees available to projects offered by REGINA would participate on a case-by-case basis. If they elected to operate jointly or parallel to REGINA's operations, their participation would be more intense. In principle, their degree of participation is dependent on their interest but limited by REGINA's character as a self-help institution of developing countries.

3. REGINA's Basic Mode of Operations

Based on the qualities of the members and industrialised countries as further participants the internal decision-making structure of REGINA is characterised by:

- host governments as sponsors of projects;
- manufacturers, presenting project opportunities or evaluating risks of technical success;
- development banks as responsible for securing or examining finance for projects.

If the project sponsored cannot be approved unconditionally because risks involved would make its financing unfeasible, the first step would be to ask project participants to try to reduce risks: host governments may be asked to create favourable infrastructure; developments banks may advance some high-risk funds to finance particularly risky operations; customers and suppliers may be approached to shoulder some of the risk in exchange for agreements serving their interest. If remaining risks might prevent the project from obtaining acceptable financing, but risks can be kept at low levels, host states and other members will be asked to advance guarantees. Their guarantees will cover a smaller volume, as their interest in the project and control over risk factors are comparatively lower.

It is at this stage that industrialised countries participate. If the members may not be able to guarantee fully the project or if industrialised countries have demonstrated their interest in a guarantee, they will be asked to elect one of three alternatives:

- they may guarantee "excess" risks that neither the project nor the country can carry;
- they may take out insurance for a proportion of all or a class of contributions to projects, the remaining volume guaranteed by REGINA's member states;
- they may create a fund entrusted to REGINA to support guarantees written by REGINA, or re-guarantee the primary guarantee written by REGINA.

According to the mode of participation, industrialised countries' influence on guarantee operations will vary:

- extending guarantees for excess risks will be at the discretion of ICs. Excess risks projects might be of particular interest to industrialised contributors which, if not for REGINA's guarantee possibility, would try to have their home states support the projects' risks;
- the guarantee of a proportionate volume of funds advanced to the project or of a special kind of funds can be done in two ways. Either the guarantees are extended by industrialised countries' institutions, or from guarantee lines which have been made available to REGINA. In the former alternative, industrialised countries would depend on REGINA for careful evaluation and monitoring of projects. In the latter, the guarantee decision would also be transferred to REGINA. This increases the discretionary power of REGINA. However, as both developing countries' member states of REGINA and industrialised countries are guarantors and may suffer equal losses, there is little danger of REGINA abusing its discretion;
- re-guaranteeing or jointly guaranteeing risks, or parts thereof, written by REGINA for its member countries, would call for the same alternatives.

Bilateral agreements between member countries and industrialised countries may institute guarantee lines in favour of projects guaranteed by REGINA. At the same time, these agreements might help control or reduce risks, as they stipulate fair conduct rules for foreign investors or other suppliers of funds. Thus, the supervisory position of REGINA may be improved, resulting in a greater capacity for control.

Relations between the members of REGINA and industrialised countries determine operational modes for REGINA. The following chapter will present examples of the way the guarantees should be put to work effectively. The examples are meant to be neither exclusive nor may they apply in every circumstance. They may be elected as appropriate, depending on the stage of development, investment policies or particular project considerations.

4. Examples for Projects' Guarantees

a) Minority Investment

REGINA's basic mode of operation is fashioned according to the prerequisites of self-help institutions. It does, however, not exclude the coverage of foreign source inflows for industrialisation. REGINA's prime task is to integrate foreign source inflows into the domestic process of industrialisation in order to gain developmental benefits for industry and the overall economy. Consequently, foreign direct investment, as long as it can substantially contribute to domestic investment, appears to be one of the primordial targets for REGINA's operations.

As a result of the guarantee, the foreign minority investor is not bound to charge the project excessive rates for finance, goods or other inputs to compensate for higher risks commonly associated with foreign minority investment. The guarantee may equally induce foreign contributors, unable to secure foreign investment financing because of balance sheet constraints, to channel additional funds to projects against project's own credit base, fortified by REGINA's guarantee.

Similarly, the guarantee may apply to larger projects, where foreign firms have been retained to supply necessary services without being eligible to acquire a substantial stake in the investment. After such a project's first phase (construction and initiating production), REGINA's guarantees may be needed to refinance export credits and other equipment, related debts falling due and, to a lesser degree, to serve as working capital. The aim of this second phase, "the technical assistance phase", is gradually to replace all foreign components in the project. During this phase, the considerable risks related to production and marketing might cause the costs of new lending to be even higher than the costs of preceding indebtedness, and so threaten further operations.

b) Majority-owned Projects

An exception in guarantees will be foreign-majority-owned projects with private domestic partners. Projects with such ownership structure may be required when developing countries want to exploit a monopoly benefit, but are not yet prepared to integrate the venture into the domestic economy. The prime reason for such a determination may be that existing linkages to the local economy are too few and too weak and the cost for creating new ones too high.

Unable to finance a project directly, developing countries might also be willing to secure a substantial shareholding in the enterprise in exchange for granting necessary rights and permits. Since the required loan finance in these cases may depend on a guarantee, REGINA guarantees may be granted to loans such as:

- projects, whose output cannot yet be processed in the country, but which yield necessary foreign exchange earnings;
- long-term projects, which for the long-term fixed assets needed and additional risk factors would unduly strain a developing country's portfolio for risks.

Loan finance needed for projects of this kind and given in view of future earnings of the project will generally require particular precautions for reducing, spreading or monitoring risks. A guarantee would help achieve this task, while providing participants from DCs with a voice in decisions relating to loan management.

c) Guarantees to Support Foreign Contractual Contributions

Guarantees extended to projects described in both previous subsections mainly support foreign contributions, by and large conforming to traditional foreign direct investment patterns, characterised by a mixture of contributions which individually and in particularly together allowed control to be exerted over the investment[1/]. The following subsection is devoted to investment patterns, which have in common their fragmentary structure of contributions, as represented by the so-called "quasi-equity" contributions. On the funding side, fragmentation of financial contributions will loosen the grip of investors over financial inputs of a project thus reducing his ability to contribute in the same way as in traditional projects[2/].

The same holds true for lenders who have relied basically on the strength of an "approved" - in home market terms - investor to run a foreign project successfully. If part of his control devolves to other participants from the project's home state or region, investors' credit standing will be unavailable for borrowing purposes. Guarantees, therefore, have to substitute for their reduced credit base and add to the perceived stability of a project by ensuring permanent support by all parties interested in its outcome. In fact, investors' control has to be replaced by a guaranteeing body's control to the degree it cannot be shifted. Several types of projects might eventually fall within this category of REGINA's proposed activities:

- projects relying directly on foreign contributions without granting foreigners the right to hold equity, or without the contributor's being prepared to acquire an equity interest in the project. The reasoning put forth in support for contribution dealt with in subsection 5 applies here with equal force.
- Guarantees may be needed particularly to finance parts of infrastructure which have fallen within the purview of equity investors. These components, the "on-site" facilities geared almost exclusively to the demands of a project, will lack sufficient funding, because contractual contributors to production are bound to look only for the means necessary to comply with their contractual

1/ See for a definition e.g. IBRD, World Development Report, 1978, Annex I, page 117.

2/ Cf. 3.5.3

obligations. As finance on soft terms will be needed to cover ancillary parts of infrastructural investment, developing countries must provide financing, unless it can be obtained by the project on the strength of a guarantee, resting on the success of the project's production.

In essence, shifting the risk of lending to a guarantee institution like REGINA will result in concentrating active "risk management" in REGINA and its participants, an entirely intended effect as participants will and shall retain project control this way.

5. Critical Issues

To conclude, the following issues essential to the activities and efficiency of REGINA are detailed: the types of guarantee cover, funding for operations and institutional co-operation.

a) Types of Risks to be Covered

A principle of REGINA's activities is the balance between the interest and cost of participation. To sustain this principle and to avoid liabilities too high for REGINA, the three classes of guarantees have been created.

Excess risk cover will be exclusively provided by industrialised countries. There are three factors which may determine a risk to be "in excess":

- Given the state of the developing country's economy, it may not be possible to diversify or insure the risk;
- the risk is equally outside REGINA's control capacity. Price or market risks are a case in point;
- industrialised countries may be most interested in supporting projects with these risks because of internal considerations or international co-operation.

Without industrialised countries' guarantees, these risks clearly cannot be accommodated by developing countries nor by REGINA. Therefore, risks are shifted to industrialised countries, which may be better able to manage these types of risk.

Risks which can be accommodated by REGINA, i.e. their member countries, may also need some external support. As these risks accumulate, the risk-taking capacity of REGINA's members would soon be exhausted. Therefore, two alternatives may be elected:

- either industrialised countries will re-guarantee part of the guarantee portfolio or a proportion of primary projects guarantees;
- or they will grant guarantees parallel to guarantees of REGINA, i.e. to other parts of the projects and its contribution.

Either way, the probability of losses will hinge on the way the projects are selected and controlled. In case of losses, they may also depend on the administration of subrogated claims if REGINA is to be entrusted with this task.

b) Industrialised Countries' Participation in Decision Making

The question of IC participation in decision making arises when ICs want to participate in the bodies determining guarantee criteria. As REGINA is designed to be a self-help institution, their influence has to be limited. Therefore, ICs have two alternatives for participation:

- limited membership in commissions determining guidelines for the selection of projects to be guaranteed or a qualified position if a more permanent role in REGINA's activities by providing guarantee lines is involved[1/]
- guarantee lines may be made available by ICs under agreements determining the final use of the guarantees. This alternative would particularly be appropriate if REGINA has already established a sound record of operations.

c) Funding

The third issue, which has played a major role in previous approaches, is funding. Since REGINA does not itself grant guarantees, this issue is relevant only as to cost of operations. Two ways to reduce these costs are offered within REGINA: fees could be charged to cover REGINA's expenses in the awarding of guarantees. Alternatively, REGINA could charge monitoring costs to the guarantors. These fees may be sufficient to cover expenses and possibly build up reserves for own guarantee operations[2/]. On the other hand, REGINA can take advantage of the existing facilities of its members. Employing their resources to the maximum may keep the association's costs rather low.

This pattern of operations should serve to achieve and preserve the operational and financial freedom necessary to develop rational and stable business criteria.

d) Losses

Another and decisive issue is connected to the probability of losses to be guaranteed. They influence costs of coverage and the capacity of guarantees to honour their committments. In view of the novelty of operations, they may reach peaks which may seem to prohibit further operations. Before such determination may be made, two arguments have to be considered: First, losses have to be seen

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1/ If excess risk guarantees would be granted this way, the guaranteeing industrialised countries might be given veto power.

2/ The amount of fees charged will also be indicative for the types of projects supported by REGINA. Moreover, if the fees will not reflect the market value attached to guarantees, REGINA will be in danger of supporting operations which would have been financed anyway.

against the losses incurred by projects otherwise foregone and by losses incurred under the old system of funding through direct investors. Secondly, guarantees by host governments have usually been given for a wide array of transactions, e.g. availability of foreign exchange, transferability of funds etc. These guarantees have not been employed efficiently. On the contrary, their effort had been a net gain for investors without any profit to the DCs. REGINA's use of these guarantees and funding guarantees may eventually reap better profits.

CHAPTER 7: CONTINGENT LIABILITIES INSURANCE CONSORTIUM: CLIC

1. Introduction

CLIC, the next mechanism to be proposed, responds to the same principal demands as REGINA: accommodation of emerging investment patterns, flexibility, and increasing developing countries' stake in the decision-making of investment. Its institutional organisation is rather similar to REGINA's, reflecting the need of transparency and of the best use and combination of existing mechanisms to supplement new institutional solutions.

CLIC is mainly concerned with foreign contractors, i.e. foreign contributors of assets, who increasingly are called to furnish the entire equipment of factories or even production processes and means. The essential difference between REGINA and CLIC lies in their respective approach to changing structures of investment. REGINA's raison d'être is the substitution of equity-funds by external funds secured by the guarantee of the projects' major beneficiaries in order to create a working identity between risk control facilities and the locus of risk within an investment project. CLIC should enable foreign contractors to assume risks for the control of which they are best suited. In addition, as new and bigger risks of contracts will exceed the risk-taking capacity of contractors, CLIC will provide an opportunity to make sure that damages caused by risks will not endanger the viability and performance of a project.

2. Relation Between REGINA and CLIC

As they are closely related in principle, the operations of both mechanisms may be complementary in reality. Basically REGINA guarantees secure repayment of funds, regardless of the risks threatening repayment. CLIC's insurance secures the termination of a project in the agreed-upon manner: insuring either particular risks or the contractors' contractual behaviour. As the orderly bringing into production of a project is one of the foremost prerequisites of loan service, they help to increase the probability of repayment.

Flexibility exists in the two schemes as risks may be shifted between covers. In any case contractual obligations of the contractor include technical assistance and maintenance over longer periods of project life, little risk may be left to be covered by REGINA's guarantees. Conversely, if all the funds of a project are guaranteed,

there may be no need to insure against project risks, which would be controlled by REGINA anyhow. For combined operations, it appears essential to determine carefully the availability of schemes and to adjust respectively the conditions for cover.

3. Scope of Problems Posed by Guarantees and Insurance of Projects in Developing Countries[1/]

a) Projects' size and the nature of risks to be insured are the essential problems to be solved or dealt with in proposing new institutions. Large-scale projects and their combined needs for insurance or guarantees can hardly be accommodated by infant insurance or banking industries in developing countries. In spite of increased efforts[2/] of developing countries to create effective institutions to cover risks occurring in domestic projects and to increase the retention capacity of regional insurance and re-insurance institutions,[3/] the amount of insurance they write will be relatively small, growing only gradually. This trend is underlined by the types of risks and their loss possibilities to be covered.

First, the incidence of risks as well as the volume of losses resulting from the actualisation of a risk may be higher due to the weak infrastructure. Logistical risks, for example, may be considerably higher in developing countries, where the project had to rely on extremely scarce resources, e.g. highly qualified manpower, an efficiently working transport system and a social and political environment, to support the project's needs in times of strain. The failure of projects planned to contribute necessary input for an accelerated industrialisation process may cause consequential losses which may run very high. Encouraging small and medium enterprises as foreign operators is not really the solution. Although this is basically the class of enterprises which should be promoted by the operations of the proposed mechanisms, the probability and volume of losses will be at least equal to large projects.

b) Three approaches may lead to a better management of problems described. The determination of guarantees or insurance coverage has to be oriented at the project in its entirety. Improved methods of project preparation, evaluation of project's risks or of the financial and technical viability of a project have to be the most important parameters for a guarantee or insurance decision.

1/ No distinction has been made between "bonds" to secure a certain performance and "guarantees" serving the same aim. As the more abstract term "guarantee" is used to cover all obligations to pay a certain sum of money if an agreed performance standard has not been met, regardless of the way the guarantee has been granted.

2/ See UNCTAD, "Review of Development in the Fields of Insurance in Developing Countries",

ID/B/C.3/99 of 8 October 1971 — ID/B/C.3/122 of 18 June 1975
ID/B/C.3/107 of 3 April 1973 — ID/B/C.3/141 of 17 July 1977

3/ See e.g. Africa Re-operative since 1 January 1978, UNCTAD, TD/B/C.3/141 of 19 July 1977, para 82, 83.

The contractor's ability to pay back monies advanced under a bank guarantee granted on the strength of his home country assets has been hitherto one of the leading considerations for granting guarantees. Insurance has been and is ordinarily given by assessing one particular risk, regardless of the combined risk of a project. The mechanisms proposed within CLIC suggest the contrary: that the target of guarantors and insurers is the project itself. It may and should be feasible without recourse to external assets. In fact, guarantees should help to create project conditions by thorough evaluation preparation and control which even improve the likelihood of the project's success. As for insurance, project oriented "wrap-up" policies[1/], taking into account the peculiar risk combination within a project framework, may replace the more traditional contracts. They may force insurers to assume functions of a "co-venturer" covering - in addition to traditional risks - design and technological risks. Covering these types of risks implies a change in perspectives. Whereas cover for risks traditionally could be arranged if risks fit into a portfolio of risks, balanced and homogeneous enough to estimate loss probability, risks due to technological default can only be covered after a profound assessment of its impact and its role within the project itself. There is some probability that even a well-assessed risk of a technological or design nature will not fit into a portfolio, as it can hardly be standardised. So it remains the duty of the insurer to see to it that in order to be ultimately insurable the risk can be shifted or reduced in other ways.

Another approach reflecting the desire of developing countries to share in the decision-making of banks and insurers is the development of domestic insurance industries. By requiring foreign contractors to hold insurance written by domestic firms and by creating regional insurance pools to increase the retention capacity of the developing economies, this aim will possibly be furthered. However, for the time being and in view of the amount of coverage needed, developing countries' efforts have need of fruitful co-operation with industrialised countries and enterprises acting on an international level.[2/]

Similarly, bank guarantees are only accepted by the contracting authority if they are channelled through or granted directly by a domestic financial institution. The institution will in turn accept banks as re-guarantors or as participants in a syndicate only if they fulfil certain requirements of credit worthiness. If these banks, or the banks originally issuing the bank guarantee to the contractor, apply equal standards of credit worthiness, contractors from developing countries, who had not yet had the opportunity to establish a reputation for credit worthiness, may not be eligible for a guarantee at all.[3/] Hence, it is important to influence the determination of what constitutes credit worthiness in this context. The determination has

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1/ E. de Saventhem: "Professional Insurance", the Consulting Engineer, September 1973, p. 25; D. Sassoon: "Versicherung öffentlicher Grossprojekte", Finanzierung und Entwicklung, 8:1978, p. 39.

2/ See reports on insurance in developing countries.

3/ See "Saudi Market opens as Sezai Turkes wins Bank Guarantee", MEED of 25 November 1977, p. 13.

has to be made in co-operation with contractors and financing institutions. Again, the aim of the institution should consist of creating a framework in which developing countries as well as other actors may operate on terms of increasing risk capacity and project stability.

Finally, beside the DCs' interest in having a stake in the decision-making institutions, a strong need exists for an internationally acceptable and effective method of risk spreading and securing. Even if an insurer may be willing to accept increased or "development" risks, he can hardly secure adequate re-insurance or he will have difficulties in syndicating the bank guarantee extended. In fact, not all of the guarantees requested could be syndicated.[1/] Problems of this kind have not surfaced frequently, as the co-operation among banks and insurance companies has been rather efficient in areas involving this type of business. However, to remove barriers for smaller contractors with high risks but capable of fulfilling contract obligations, the co-operation between these institutions has to be supplemented and stabilised. Doing so will permit developing countries to introduce their justified demands into the decision-making process and will permit contractors as well as host countries to rely on these fora for efficient risk spreading.

The aim of a permanent body for the syndication of liabilities arising out of insurance coverage or bank guarantees may be enhanced by harmonising contract conditions.[2/] Maturity of guarantee and insurance contracts, provisions for the cancellation and renewal of contracts or the roll-over of guarantees and obligations to reduce guarantee liabilities or to return notes after the termination of the contract are all questions with a strong impact on the contractor as well as the contracting authority and the host state. Harmonisation will, in any case, improve transparency of markets and stability of contract relations. Harmonisation of conditions may help reduce uncertainties of coverage and cost of coverage. For the contractor, it may clearly determine their capacity to refinance operations, as guarantees often limit his credit standing. On the project side harmonised and balanced provisions may e.g. remove doubts as to the future coverage of certain risks.

4. CLIC - A Proposal for a Mechanism

The preceding sections should have brought out three areas of activities for CLIC:

- CLIC must provide the contractor or the project's owner with the possibility to externalise risks which threaten to impair his capacity to fulfil his contractual obligations quickly and efficiently. The predominant prerequisite for a workable

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1/ "Major Bank Guarantee for Saudi Arabia Arranged", Financial Times of 25 October 1976

2/ See e.g. ICC, "Uniform Rules of Contract Guarantees", 1st edition, Paris August 1978.

shifting of risks is a thorough and exhaustive assessment of the type and magnitude of risks occurring during contract life, given the economic conditions of a particular country.

- CLIC has to insure that for the sale of risks properly assessed, markets can be found, broad enough to guarantee a wide distribution of risks and deep enough to assure the securing of risks even in times of economic stress and/or little standing of the insured party.
- under the aegis of CLIC, ways have to be established to either eliminate or control classes of risks. The balance of interest required to reach this aim could be furthered by creating equitable contract conditions for guarantees and insurance and by harmonising market conditions.

To achieve these aims, CLIC should give precedence to flexibility and industrial development co-operations. This would mean that CLIC should try to assist national and other institutions to combine forces to offer an overall balanced yet project-tailored programme. This may best be reached by forming a consortium on a permanent basis with three principal functions.

Risk assessment would be the basic function. Technical experts from developing country institutions, banks and reinsurance companies should co-operate to determine the character and the magnitude of possible risks. To achieve a climate of professionalism and mutual trust, the consortium should be established with UNIDO as a driving force. The assessment of risk will be the precondition for the determination of ways to reduce, shift and cover risk. Reduction may be achieved by supplying technical advice to the project or possibly by creating conditions to control the technical and financial aspects of risks.

To shift risks, it is necessary first to examine all participant's risk-taking capacity, their possible influence on the occurrence of risks and their interest in the projects' success. Given an assessment of development risks and the corresponding determination of control possibilities, the findings could require a more direct involvement of developing and industrialised countries in order to reduce non-insurable risks. The assessment panel may, therefore, ask these participants to provide for certain undertakings of developing countries in respect to development risk.[1/] Industrialised countries will be asked to open credit or guarantee lines with their export/investment guarantee systems to insure remaining development risks which may, nevertheless, occur. Risks determined as not being of that nature might be better insured on commercial terms.

Other measures conducive to risks limitation are standard clauses for guarantees, which will emerge in the course of the activity of the panel. They can be supported by a body of arbitration decisions, handed down by UNIDO's tribunal; decisions of this

1/ For the corresponding term "development losses", see chapter of the study.

body may be made compulsory for the applicants on a risk assessment procedure. Applicants may include all parties involved in a project in developing countries for which risk cover is mandatory.

The necessary concomitant for the assessment panel is the loss documentation panel. It has to be ensured that amounts guaranteed may be available on the shortest notice so as to minimise risks caused by delay due to arguments over the necessary evidence to file a claim. On the other hand, there may be cases where an argument will arise whether particular cases would fall within a special sphere of influence for which no cover had been obtaind. It should be incumbent on the loss documentation panel to examine such a matter speedily and, without going into detail, give a preliminary finding. In addition, to increase the efficiency of insurance decisions, the panel may be required to accumulate more comprehensive information - from assessing or risks to the examination of losses.

Finally, CLIC may serve as a permanent consortium for the syndication of guarantees. Given the thorough assessment and the undertakings and patterns to be followed by all participants, membership in a consortium of international financial and insurance institutions doing business in high risk, but still profitable areas, may be attractive. In exchange, participants, including industrialised countries' public guarantee programmes, would be asked to pledge a certain amount of guarantees or insurance during a certain time period to be sold to projects' owners or contractors. The pledges in turn may grant stability for additional insurance to be written.

CHAPTER 8: REGINA AND CLIC: ADVANTAGES OVER COMPETING SCHEMES

The following survey of related institutions should not only demonstrate a possible superiority but also try to determine the position of the mechanisms proposed vis-à-vis other schemes.

REGINA in particular should be able to reach a high mobilisation factor. It appears to be capable of attaining degrees of mobilisation of sources for capital reached by co-financing operations.[1/] The catalytic character of operations correlates to a need of other financial institutions to assess and evaluate projects (risks) correctly. Arab funds in particular have shown a rapid rise of disbursements for projects originally examined and tested by other, especially international, financial

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1/ It should be borne in mind that mobilisation of funds to a project through high-risk lending engenders a "multiplier" effect on two levels:

- horizontally, as the secured credit may be the top layer of a financial package;
- vertically, as e.g. a loan for investment purposes will increase the capacity of a project to attract funding for current asset finance.

institutions.[1] REGINA and CLIC may serve as "financial engineers" to match project opportunities and funds (insurance) from industrialised countries. REGINA would reach a better mobilisation and transformation factor by perfecting control opportunities over projects; CLIC would extend its financial services to create an efficient system for syndication.[2] Syndication as the "down-stream" alternative for risk transformation will help attract even more and qualified contributors to projects on conditions which can be at least influenced by developing countries. Furthermore, a perceived stability and transparency of the syndication process, furthered by the creation of harmonised conditions for insurance contracts and guarantees, may ensure better planning and implementing conditions for the participants of projects as uncertainties in the area of finance can be kept low.

This aim is all the more important, as on a lower level only very few institutions can attract capital from industrialised countries' market sources.[3] In addition, the closeness to projects guaranteed and insured may contribute to the effectiveness of control and supervision of projects' risks. The control, and in particular the control of "political" risk indices on projects' situation, is helped by the permanent interaction with the host state's policy-making bodies. However, their influence is matched by other participants in the decision-making process of the institutions, which will secure technical and financial advice and guidance on an independent basis. The decisions, reflecting the mix of the participants, should, therefore, be guided by considerations of domestic industrial policy but not focused on temporary changes.

The limited potential for large operations in the regional framework stimulates operational patterns reflecting a flexible attitude towards patterns of contributions. Contrary to many investment guarantee institutions, which require applicants to have a substantial share-holding in the investment, REGINA and CLIC should have no need to resort to such rigid prerequisites. Substantiality, which as a rule may be determined on a showing of a shareholding of over 10 or 25%, may interfere with guarantee requirements of multilateral ventures, allowing each of the participants only a limited number of shares.[4] On the other hand, schemes using this and similar tests have no other choice than rigid regulations. As they lack the resources and the necessary mandate

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1/ The Saudi Fund has rapidly increased its commitments by lending to co-financed projects. Even within the Arab institutions this effect still is felt. BADEA e.g. through indirect participation of other Arab institutions has attained a mobilisation factor of 24% of total project cost, see "New African" July 1978.

2/ James A. Nelson, "Middle East Contractors need Specialised Bank Services", MEED Special Report "Banking and Finance," December 1977, page 17.

3/ Only few financial institutions from developing countries had the opportunity to tap foreign markets for long term development funds, like e.g. IMDB of Iran or Nacional Financiera S.A. of Mexico.

4/ See for the problem of multinational projects and investment insurance, Kay "Problems of Multinational Investor Eligibility under National Investment Insurance Programmes", Texas International Law Journal, 7 (1972) 223. Export credits and insurance is at least to an equal extent dependent on home state considerations.

to examine projects in depth, they must apply rigid rules. Thus, they may only react retroactively on new developments without having an opportunity to influence trends in investors' behaviour. The proposed mechanisms, on the other hand, may - by changing their control instruments and procedures gradually - react to emerging patterns of investment or even initiate processes in keeping with industrial policies of the projects' state.

Another advantage over institutions operating from industrialised states is the "project perspective". Although untied project loans may be granted by industrialised countries' institutions, the lending decision is commonly guided by considerations at least partly reflecting industrialised countries' policy perspective, which is alien to a developing countries' project. This pattern will result in procurement conditions, financial covenants and funding terms based on e.g. the goods financed or the impact of the project insured on future business. Export credits, a handy device for the finance of foreign currency expenditures for capital goods, are not the only tied credits; the volume of subsidisation is also dependent on the industrialised countries' domestic economic situation regardless of the volume of trade to developing countries.

Finally, the active involvement in project risk management may be said to be an important advantage of the proposed institutions. In this regard, REGINA and CLIC follow international financial institutions which have searched for, evaluated and financed projects, giving them an opportunity to supervise and monitor projects' success effectively.[1/] They, thereby, were able to observe closely indicators of performance.[2/] If indicators effected a warning, the institutions had still time to consider effective countermeasures. On the basis of a thorough evaluation of the project in connection with a knowledge of local political developments, REGINA and CLIC should be able to, first, identify and develop useful indicators for the occurence of risk. Secondly, their capacity to take quick and appropriate action may even be higher compared to financial institutions operating on higher levels.

Most of the presumed advantages of REGINA and CLIC will depend on the success of their industrial development co-operation. Both rely basically on a concept of self-help, supported in varying degrees by industrialised countries' capital guarantees and enterprises. This concept implies that decision making will take place within the circle of the institutions' participants from developing countries.[3/] Industrialised

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1/ For some of the methods used to secure repayment, practised by financial institutions see Mr. Fritsche/A. Stockmayer "Mineral Agreements: Issues of Finance and Taxation", Natural Res. Forum, 2 (1978) 215ff.

2/ See for the control aspect in particular Andrés Sureda/Charles Vuylsteke "La Surveillance exercée par La Banque Mondiale" in: G. Fischer/D. Vignes, La Surveillance Internationale, Bruxelles: Bruylants 1976, p. 299.

3/ However, at a given stage of development, developing countries will not have the capacities to rely entirely on their own. Even in the area of insurance, where developing countries' efforts have been particularly intense, international co operation will be necessary for theyears to come, cf. UNCTAD, "Insurance of Large Risks in Developing Countries, TD/B/C.3/137, p.23.

countries will have a say in decisions in as much as their support is involved. With respect to BEGINA, guarantees by industrialised countries are granted to projects on criteria developed by BEGINA but approved by industrialised countries. The day-to-day administration and the operational patterns are outside their control. They may, however influence the course of action of institutions in an indirect way, as they decline to grant guarantees. A good performance record by the proposed institution can prevent this development. Cooperation based on the mechanisms will not, therefore, require a degree of control which has prevented former proposals from being realised.[1/] Cooperation based on these principles might produce better results (becoming more stable and balanced over time) than efforts to involve industrialised countries on a broader basis.

It has been proposed, for example, that industrialised countries guarantee projects sponsored by developing countries on the conditions that these projects are bilaterally approved.[2/] Such broad guarantees are not inserted into the overall framework of a project: participants are unguided by an insurance rationale, and not stricted oriented at the projects' other needs. Under such conditions the method selected for cooperation or the projects selected for support may be optimal only from the viewpoints of the administrations. Therefore, given a possible imbalance in decision making, the developing countries could be left with a project or a contribution to a project inappropriate for its industrialisation process.

There is a fair chance that upon the assessment by an internationally balanced group of experts and the concurrent decisions of a number of participants of the projects (including home state authorities), a guarantee or insurance contracted under CMIC's auspices will be more indicative of the proper function and value of the project and will better serve the home state economy than a government guarantee.

1/ The most prominent example of a multinational investment guarantee, the IIIA has been a victim of persisting argument over the requisite share of developing countries and industrialised countries in the governing organs and in the funding of such an institution. Given the long period of preparation for the IIIA and its predecessors based on the same model of international guarantees, it may safely be assumed, that the model has failed. (IIIA has been based on work done within the IBRD since the beginning 60s. It could rely on the 1967 Draft Convention on the Protection of Foreign Property).

2/ See i.a. the very comprehensive note by Phillipe Kahn, "on a suggestion concerning guarantees in industrial co-operation government contracts", ID/WG.287/4, 8 November, 1978, paras 16 passim.

CHAPTER 9: CONCLUDING REMARKS

Both proposals for mechanisms are far-reaching. Although they rely on previous approaches which have demonstrated that a need exists they may not become operational for various reasons. Although external reasons could be one cause of failure, most of the issues critically important for the mechanisms' success lie in how REGINA and CLIC are organised. Two examples may illustrate it:

1. Both mechanisms depend on the amount of professional skill they can muster. Besides the willingness of industrialised countries to commit guarantees and the feasibility of internal co-operation, these skills will influence the performance record, i.e. the capacity to mobilise sources and transform risks.

2. Regional co-operation will be the other factor upon which success hinges. Without it, the close relationship to projects and the access to international funding will not be viable. And the flexible attitude to projects on the basis of harmonised policy decisions will not be achieved.

But given the skill and the will for regional co-operation, the mechanisms should by their balance of economic necessity and political determination create better conditions for funding or investment beneficial to all participants.

STUDY ON THE PERFECTION OF THE EXISTING MECHANISM FOR THE SETTLING OF COMMERCIAL DISPUTES

by

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CHAPTER II. THE ACTIVITIES OF THE GERMAN DEMOCRATIC REPUBLIC IN THE FIELD OF INTERNATIONAL COMMERCIAL ARBITRAGE

The legislation of the GDR and of all the other member countries of the Council for Mutual Economic Assistance (CMEA) provides two mechanisms for the settling of international commercial disputes:

(a) state jurisdiction (judiciary)

(b) non-governmental arbitration (arbitrage).

The state courts of these countries have a broad competence in civil matters which means that there are not special state courts dealing with commercial matters (commercial courts) and that no special divisions or senates for commercial matters are attached to the state courts. Access to the state courts in matters dealt with here is regulated by national legal provisions concerned with international jurisdiction, as has been laid down in the GDR in Arts. 134 and 135 of the Civil Procedural Code of June 19, 1975.[1/]

1/ Arts. 134/135 of the Civil Procedureal Code read as follows:
Art. 134: Rules of Competence
(1) The courts of the German Democratic Republic are competent for proceedings between parties from other States, if, under the provisions of this law or other legal provisions, they have jurisdiction ratione loci.
(2) The courts of the German Democratic Republic are also competent if one party is a citizen of the German Democratic Republic or has his domicile, abode or seat in the German Democratic Republic, or an obligation which has arisen or shall be fulfilled here or if, in civil matters, assets of the defendant are located in the German Democratic Republic.
(3) If, under the provisions of this law, no court is locally competent to conduct the proceedings, that court of the German Democratic Republic is competent, in whose circuit the plaintiff has his domicile abode or seat provided that the defendant has no domicile, abode or seat in the German Democratic Republic. In any other cases, the Stadtbezirksgericht Berlin-Mitte is competent. It may refer the proceedings to another court.
(4) In order to establish the jurisdiction of the courts of the German Democratic Republic those circumstances are decisive which exist at the time when the action is served. A jurisdiction, once established, remains competent even if the prerequisites subsequently cease to exist.
Article 135: Agreement on Competence
(1) In civil matters the parties may agree to confer jurisdiction to the courts of the German Democratic Republic, even if the latter have not jurisdiction under this Part. The agreement may be tacit or explicit - Jurisdiction is considered to be agreed if the defendant participates in the proceedings on the matter.
(2) Insofar as an action does not come within the exclusive jurisdiction of the courts of the German Democratic Republic, cognizance over and decision in a civil matter may, by written agreement between parties, whereof one has his domicile, abode or seat outside the German Democratic Republic, be conferred to the juridiction of the courts of another State or, if provided by law, to an arbitration court.

These provisions of the GDR coincide, to a great extent, with those of other CMEA members.[1/] The legal provisions of these countries allow for the contractual agreement on international jurisdiction of a court (Judicial Competence Clause).

An analysis of practice shows that dispute settlement through arbitrate is considerably more often chosen and implemented through state courts, but it should be noted that arbitrage in the GDR and in the other CMEA countries is understood as an arbitrage de jure, like state courts, basing its decisions on juridical considerations. Why then is such preference of arbitrage given by the partners of international economic contracts? The reasons are:

- pecularities of arbitrage, such as proceedings with a short and inexpensive duration, experts as judges,[2/] the right to select arbiters, complete separation between arbitrage and judiciary,[3/] immediate binding force (legal effect) of the decisions taken by the arbitration court.[4/]

- international character, more of less distinct, of arbitrage. whereas the state courts as orgens of a certain state must necessarily be nationally oriented. Here we must take into consideration that arbitrage in the GDR and in the other CMEA countries operates, as a matter of principle, solely within the scope of international economic matters and has, therefore, completely adjusted to its requirements.

This is linked with:

- the special character of settling disputes by arbitrage. The possibility of choosing arbiters and the existence of lists of arbiters allow for mechanism of settling disputes to be adapted to the peculiar features of the individual dispute.

1/ e.g. CSSR, the Act. No. 97/1963 Concerning Private International Law and the Rules of Procedure Relating Thereto (Bulletin of Czechoslovak. Law, Prague, 4/63, p. 249). L. A. Lunz, Internationaler Zivilprozess, Staatsverlag der DDR, Berlin 1968, p.44 et seq.

2/ The arbiters are, after having been confirmed by the Presidium of the Chamber of Foreign Trade of the GDR registered in a list of arbiters kept by the Secretary of the Arbitration Court. Similar rules apply to the other CMEA countries. By publishing the list of arbiters the Chamber guarantees that the listed persons are top grade experts. have special knowledge and practical experience in the relevant field and are persons of moral integrity.

3/ The consequence is that e.g. in the GDR arbitration awards, in case of legal defects are not subject to cassation by the Supreme Court. The separation from the judiciary is admittedly not total: for the order of enforcement of an arbitration award the court is competent in the GDR (unlike in Romania), as well as for the order and carrying out of the enforcement actions.

4/ The legal institution of depositing awards with the state court was in the GDR abolished in 1975; it had rarely been observed.

In short: In the socialist countries, arbitrage is regarded and propagated as the adequate method for settling disputes, optimally adapted to the conditions of international economic and scientific technological co-operation.

Disputes arising from international economic relations between nationally-owned enterprises, combines or other national economic organisations of the GDR are not subject to arbitration nor to state court jurisdiction. For that purpose a special state organ was set up in 1951 and revised several times since then, namely the State Contract Court attached to the GDR Council of Ministers (with a Country Contract Court in each of the 15 countries of the Republic and headed by the Central Contract Court). In contrast to its title as State Contract Court, this is not a GDR court but an administrative organ which proceeds in a court-like manner. In no way is it qualified to deal with disputes arising from contracts with a foreign partner. We mention this dispute settling mechanism, which is based upon the national economic combination of plan and contract, because lacking knowledge about the CMEA countries' legal system non-socialist countries repeatedly confuse the contract court with commercial arbitrage. Serious misjudgements of arbitrage in these countries result. Such mix-ups may be because the State Contract Court in Russian is called "gossudarst-wennij arbitrash", meaning State Arbitration Court.

In GDR legislation, international arbitrage has been stipulated by the Regulation on Arbitration Proceedings of December 18, 1975.[1/] Such a special law for arbitrage also exists in the CSSR[2/] and in Cuba.[3/] Other CMEA countries deal with these issues in special sections of their civil procedural codes. Such laws were issued in the past ten to twenty years. Despite their differences in detail, they share a similar concept: all favour arbitrage. They allow for the broadest access to arbitrage and establish proceedings to protect participants. To assure that decisions reached through arbitrage are honored, minimum legal requirements are catalogued. No uniform provision exists regarding determining if the general civil procedural provisions should be used to close gaps in these special legal provisions on arbitrage.[4/]

The most recent legislation in this field is that of the GDR.[5/]

1/ Law Gazette 1976, Part I, No. 1, P. 8.

2/ The Act No 98/1963 Relating to Arbitration in International Trade and to Enforcement of Awards, Bulletin of Czechoslovak Law, Prague, 4/64, p. 267.

3/ Hector Garcini, The Republic of Cuba, Yearbook Commercial Arbitration, Vol.I, 1976, p. 27.

4/ The corresponding legal provision of the GDR leaves the procedure to the rules agreed upon by the parties and to the discretion of the arbiters. The arbiters may, on the basis of that discretion, apply the provisions of the Civil Procedural Code which, in such a case, do not operate as legal provisions. According to the law of other CMEA countries the general provisions of the Civil Procedural Code may, subsidiarily, apply to arbitration court proceedings where they operate as legal provisions. This distinction is of importance for the rescission of awards, as it may be moved in the case of procedural provisions being violated.

5/ Ordinance of December 18, 1975 on Arbitration Court Proceedings, cf. footnote 1.

Its most important provision states:

> "Within business relations[1] the partners may agree that an arbitration court shall deal with and decide any dispute between them, which has arisen or might in future arise." (Art. 1 of the Ordinance of December 18, 1975).

In order not to limit the scope of arbitrage, this ordinance does not supply a legal definition of the term "business relations" and also avoids the term "commercial matters" which is used in international conventions although its interpretation and application are contested. Furthermore, Art. 1 of the Arbitration Court (Rules) foregoes characterizing commercial matters, or any dispute arising from them as "international" or "foreign". The new legal provision is flexible enough to allow interpretation and application in such matters as the relationship between authors and publishers and relationships between international economic organisations and other institutions of the country where it is based.

In particular, the Ordinance applies to the following subjects: admissibility of arbitrage: arbitration clause, its form and legal effect: the proceedings to be applied: the settling up of arbitration: challenging arbiters: venue of the arbitration court: service: introduction of proceedings: contents of the petition: cross action: withdrawal of the petition: principles of proceedings (right to be heard, trial in camera): taking of evidence: settlement: arbitral award (pronouncement, contents and effect): rescission of award[2]: enforcement: execution.

1/ As a result of the special regulations on the domestic business relations this provision reads as follows: "In international business relations..."

2/ In all CMEA countries the arbitration court proceedings have only one instance. No legal redress is admissible which leads to a substantial examination of the decision nor is cassation possible on account of a gross violation of the law. (The right to move a cassation lies in the GDR, e.g., in the hands of the Procurator General and the President of the Supreme Court.)
An arbitration award or a settlement in the arbitration court can be rescinded only on account of a gross violation of procedural provisions. So far no case of a rescission of decisions taken by an arbitration court has occured in the GDR. The laws of the USSR do not contain the legal institution of rescinding arbitration court awards where they become effective only after a period of one month within which the effects of any procedural defects on awards can still be eliminated.

Two provisions deserve emphasis:

- as to proceedings, reference is made to the application of the rules agreed upon by the partners[1/] (by expressly referring to the model arbitration rules customary in international business relations) (Art. 5);

- the national arbitrage law of the GDR must not be applied except in international agreements in which the GDR takes part, unless other stipulations have been made (Art. 32).

Similar provisions are contained in the ordinances adopted by the other socialist countries.

The four international Conventions[2/] in the field of arbitrage are applied by most of the CMEA countries, which have, to a certain extent, taken part in drafting them.

They are:
- the Geneva Protocol on Arbitration Clauses of September 24, 1923;
- the Geneva Agreement on the Execution of Foreign Arbitration Awards of September 26, 1927;
- the Convention on the Recognition and Execution of Foreign Arbitration Awards of June 10, 1958, and:
- the European Convention on International Commercial Arbitrate of April 21, 1971.

The CMEA countries' participation in these four Conventions is as follows:

Countries	1923	1927	1958	1961
Bulgaria			+	+
Cuba			+	+
CSSR	+	+	+	+
GDR	+	+	+	+
Hungary			+	+
Mongolia				
Poland	+		+	+
Romania	+	+	+	+
USSR			+	+
Vietnam				

1/ Such as e.g. Provisions of the Arbitration Court Rules of permanent or institutional arbitration courts.

2/ Not considered here are international conventions within the sphere of the socialist economic integration of the CMEA countries, such as e.g. the Convention of May 26, 1972, on the Decision of Civil Litigations by way of Arbitration, resulting from economic and scientific technological co-operation.

Romania moreover participates in the Washington Convention on the Settlement of Investment Disputes (1965).

It is worth noting that the national legal stipulations of CMEA countries, such as e.g. the USSR Ordinance on Arbitration Proceedings of December 19, 1975, go farther in encouraging and applying international arbitrage than do the international conventions.

The close and economic scientific technological co-operation between the CMEA countries in the process of their economic integration made the perfection of the legal basis of that integration necessary and feasible.[1/] The far reaching complex measures for drafting and improving legal regulations, also perfects arbitrage methods partly by extending contractual regulations and partly through independent actions.

These steps are explained in more details **elsewhere**,[2/] but we must point out here that since 1953 arbitrage has been the sole method of settling disputes within contractual relations between foreign-trade enterprises of the CMEA countries. State courts of these countries have been excluded from disputes arising from foreign-trade contracts since 1958, which is why one spoke occasionally of obligatory arbitrage.

In about 1970 more than ten years of experience in settling disputes through arbitrage led to the decision to settle all types of international commercial contractual disputes only this way. The legal basis of the extension of the principle, which had been introduced as early as in 1958,[3/] to contracts beyond the delivery of goods, became the Convention of May 26, 1972 on the Settling through Arbitrage of Civil Disputes which result from relations of economic and scientific technological co-operation (the so-called Moscow Convention of 1972[4/]). This is an open convention which is not connected **with membership in CMEA. Uniform rules** [5/] **were elaborated for all permanent arbitration courts attached to the Commercial and Industrial Agreements of the CMEA countries (in the GDR the Chamber of Foreign Trade) to be understood as model rules.** The authorities, which issue arbitration rules - in the GDR, the Presidium of the Chamber of

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1/ Complex programme of July 1971 for the Further Deepening and Perfecting of Co-operation and Development of the Socialist Economic Integration of the CMEA countries. Chap. IV, Section 15: Perfection of the Legal Bases of Co-operation between the CMEA countries. The Complex Programme has been printed in the collection Grunddokumente des RGW, Staatsverlag der DDR, Berlin 1978, p. 47 et seq.

2/ Yearbook Commercial Arbitration Kluwer V.B., Deventer, Netherlands. Vol.I. 1976, p.4.

3/ Manfred Kemper, Heinz Strohbach, Hellmut Wagner, Die allgemeinen Lieferbedingungen des RGW 1968 in der Spruchpraxis sozialistischer Aussenhandelsschiedsgerichte, Kommentar, Staatsverlag der DDR, Berlin 1975, p. 386 et seq.

4/ English translation of the Convention on Multilateral Conventions and other Instruments on Arbitration, published by Asociazone Italiana per l'Arbitrato, Rome 1974.

Also in International Commercial Arbitration, Documents and Selected Papers, Clive M. Schmitthoff, Oceana Publications, 1974/75, 2nd Part, p. 250.

5/ An English Translation of the Uniform Rules is reproduced in Part III of Vol. I-1976 of the Yearbook Commercial Arbitration, footnote 16.

Foreign Trade of the GDR - adapted, in 1975/76 their own rules to those Uniform Rules, and issued new arbitration court rules covering all questions involving law enforcement. As a matter of principle, these new rules apply to all categories of disputes irrespective of the origin of the litigants.[1/]

The legislative measures of the CMEA countries for the extension of the law of arbitrage directly benefit the trade and business partners of these countries within the non-socialist economic sphere. They encounter in the CMEA countries a fully developed commercial international experience and a solid legal basis in national legal enactments concentrating on a method by which CMEA countries have settled commercial co-operation disputes since 1958[2/] could not but promote the development of arbitrage. The two main measures of unification, the Moscow Convention of 1972 and the Uniform Rules, have made a major contribution toward raising to a uniform high level the concepts of the "national" arbitration institutions which had arisen at various times from different national legal concepts. This is all the more significant as the sphere envisaged here does not only comprise Eastern and Central European countries, but states such as Cuba[3/] and Mongolia[4/] which adhered to completely different concepts or none at all before joining CMEA.

Today all CMEA countries, to a great extent have uniform permanent arbitration courts in terms of legal basis and mode of operations. The foreign businessman encounters rules of procedure which can be easily understood without resorting to legal experts. They are in all the major issues of initiating, implementing and finalising proceedings as well as the settlement of costs [5/] rationalizes the seeking of legal redress by foreign business partners.

1/ An exception is made by the Panel of Arbiters of the Polish Chamber of Foreign Trade which applies the Uniform Rules directly but only to proceedings between enterprises of the CMEA countries which means that the Warsaw Collegium of Arbiters operates on the basis of two different arbitration court rules.

2/ As a matter of course arbitrage in these countries was in force prior to 1958. The Moscow Commission on Foreign-Trade Arbitration was set up in 1932, the other permanent arbitration courts mostly in the late forties or early fifties. They dealt, from the beginning of the co-operation between these countries, with disputes between economic organisations of these countries, because, at first, the bilaterally agreed general terms of delivery provided arbitrage as a method of settling disputes. The year 1958 marks the transition to multilateral general terms of delivery and to the normative character of the thereby included provision on the settling of disputes.

3/ Cf. footnote 3 page 3.

4/ Davazhabin Dazhdondog, Mongolia Yearbook, op. cit., p. 63.

5/ Costs are low. As an example a few positions of the table of fees of the Arbitration Court attached to the Chamber of Foreign Trade of the GDR are mentioned: the fees correspond to value in litigation, namely:

for a value in litigation up to	10,000 M	800.---M
" " " " "	20,000 M	1.600.---M
" " " " "	50,000 M	3.000.---M
" " " " "	100,000 M	4.000.---M
" " " " "	500,000 M	6.000.---M
" " " " "	1,000,000 M	10.000.---M
" " " beyond	4,000,000 M	40.000.---M

Out of the fees the honorariums for arbiters are paid and the administrative costs of the arbitration court recompensed.

The impetus for the development of arbitrage in the CMEA countries has been the economic co-operation among these countries. Changes in economic co-operation within the process of socialist economic integration are reflected in the structure of the disputes and the increase in demands made on the methods of settling disputes. Although now as in the past most disputes involve the delivery of goods, disputes now arise from contracts concerning the delivery of plant and factories, scientific-technological co-operation and production co-operation.1/

Like other socialist countries, the GDR has endeavoured to share its experiences in international commercial arbitrage. The GDR took an active part in drafting the UN Commission on International Trade Law (UNCITRAL) Arbitration Rules of 1976. Experts from the Chamber of Foreign Trade of the GDR have participated in the International Council on Commercial Arbitration (ICCA) and International Arbitration Congresses which were held mainly to promote the settling of disputes in developing countries through arbitrage.2/

What has been said so far demonstrates that the central issue of the settling of disputes through arbitrage lies with the permanent arbitration courts and the commercial and industrial chambers of the CMEA countries as organs in charge of that arbitrage.3/ Over and beyond, arbitrage ad hoc has its significance. The legal provisions in these countries refer equally to either form. Co-operation in the UNCITRAL Arbitration Rules of 1976 and the broad propagation of these Rules and the UN Economic Commission for Europe (ECE) Arbitration Rules of 1966 characterise the promotion of arbitrage ad hoc by the GDR authorities. The Chamber of Foreign Trade of the GDR is, according to its Statute, prepared and committed to support this form of arbitrage. Thus it functions, e.g. as Appointing Authority should the litigants express this wish and makes its rooms and technical-organisational facilities available for the realisation of arbitrages ad hoc.

The fact should be stressed that the Chamber of Foreign Trade of the GDR, like a number of chambers of commerce and industry of other CMEA countries, has often declared its readiness to conclude with corresponding institutions of the developing countries agreements on co-operation in the field of arbitrage and, above all, on the mutual

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1/ Ernst Cohn, Martin Domke, Frederick Eisemann - Handbook of Institutional Arbitration in International Trade, Facts, Figures and Rules.
- Court of Arbitration attached to the Chamber of Foreign Trade of the German Democratic Republic, p. 59.
- Court of Arbitration of the Polish Chamber of Foreign Trade, p. 147.
- Court of Arbitration Commission of Romania, p. 165.
- Foreign Trade Arbitration Commission at the USSR Chamber of Commerce and Industry, p. 273.

2/ So far six of such Congresses have been held: Paris (1961), Rotterdam (1966), Venice (1969), Moscow (1972), New Delhi (1973), Mexico City (1978). In between such Congresses so-called Interim Meetings take place, such as London (1974) and Vienna (1976).

3/ No mention is made here of the special and branch arbitration courts, such as the International Court of Arbitration for Maritime and River Shipping Gdynia, the Moscow Sea Arbitration Commission, the Cotton Arbitrage Gdynia, the Court of Arbitration of the Wool Chamber Gdynia.

recommendation of a coordinated model arbitration clause. Such an agreement exists already with the Federation of Indian Chambers of Commerce and Industry (FICCI) in New Delhi.[1/]

It is generally known that dealing with arbitrage ad hoc is considerably more difficult both for the litigants and for the arbiters than to use the services of a permanent arbitration court. On the other hand, arbitrage ad hoc offers absolutely irreplaceable advantages as to its speciality and individuality regarding the nature of the dispute, the litigants and the arbiters.[2/] The efforts undertaken by the chambers of commerce and industry of the CMEA countries are particularly directed at making, within their scope of influence the fullest use of these advantages and by limiting the legal hazards which are connected with arbitrage ad hoc. This explains the propagation of model arbitration rules (ECE, UNCITRAL), the recommendation of model arbitration clauses with legality safeguarded contents and the co-operation as Appointing Authority or administering body.

The activities of the GDR in the field of commercial arbitrage manifest themselves:

- in national legislation by the introduction of a legal regulation in keeping with the requirements of modern international business relations;
- in the legal activities of CMEA through its co-operation in setting up uniform legal foundations of arbitrage (Moscow Convention) and Uniform Arbitration Rules for permanent arbitration courts;
- in the legal activities of UNO by accession to and application of the four international Conventions (1923, 1927, 1938 and 1961) as well as co-operation concerning UNCITRAL Arbitration Rules of 1976 as well as the UNCITRAL Conciliation Rules which are being prepared.
- In the foreign trade practice by an extensive use of arbitration clauses in contracts of enterprises as well as by maintaining a permanent arbitration court for international contract disputes at the Chamber of Foreign Trade in the GDR, by lending support to arbitrages ad hoc by propagating model arbitration clauses and model procedural rules and by making available the good services of the chambers of commerce in technical organisational regard.

1/ No mention is made here of such agreements between chambers of commerce of other CMEA countries and of further agreements between the Chamber of Foreign Trade of the GDR with the Japan Commercial Arbitration Association, the Associazione Italiana per l'Arbitrato, the Bundeskammer der gewerblichen Wirtschaft, Vienna.

2/ Heinz Strohbach, Die Arbitrage ad hoc and ihre Regelung unter besonderer Berücksichtigung der UNCITRAL Schiedsgerichtsregeln 1976, published by the Legal Service of the Chamber of Foreign Trade of the GDR, Berlin 1977.

CHAPTER 2: EXPERIENCES OF THE FOREIGN TRADE ENTERPRISES OF THE GDR IN THE FIELD OF ARBITRAGE

The experiences of GDR Foreign Trade enterprises present a varied picture. It is difficult to generalise because of: (1) differences in export and import situations, particularly when the two operations are supervised by different enterprises, (2) transactions involving agriculture produce and those involving machinery or industrial plants, (3) trade regions.

The bulk of transaction with companies of developing and capitalistic industrialised countries is concluded on the basis of general trading terms.[1/] When the general trading terms of the GDR enterprises are accepted arbitrage is, as a rule, provided as a means of settling disputes. This is, in most cases, an exclusive arbitration clause. Optional clauses also occur which means that in case of a dispute the plaintiff is entitled to apply to the agreed arbitration court or the state court with jurisdiction over the defendant.[2/] Such an option cements the clause and reduces it either to a simple arbitration clause or a clause identifying what court will handle disputes. If these general trade terms mention arbitrage, reference is made, as shown in the printed text, to the permanent arbitration court attached to the Chamber of Foreign Trade of the GDR.

It goes without saying that such a printed clause can be rendered ineffective by an explicit agreement between the contracting partners and a corresponding remark in the text of the contract in favour of a different kind of settling disputes or no substitution indicated.[3/]

If, however, general trade terms of the foreign partner apply, their clauses of settling disputes also operate: reference to the state courts in arbitrage by the International Chamber of Commerce in Paris (ICC) or a certain type of arbitrage ad hoc. Everything depends on whose general trading terms have eventually become a component part of the contract.

Practice shows that GDR enterprises are adverse to accepting the ICC clauses. They see in ICC an organisation of the capitalistic industrial countries and an agent representing the interests of those firms and institutions belonging to national committees or the organisation.[4/] ICC machinery - nomination of presiding arbiters ex officio and

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1/ Designations differ: General Delivery Terms, General Purchasing Terms, Delivery Terms.

2/ The kind of a dispute has an important effect on the option: as a rule the state courts are preferred for the enforcement of pure payment claims.

3/ The laws of the GDR do not contain such, tough clauses as e.g. does Italian legislation. According to GDR law, the arbitration clause included in the general business terms may be agreed upon without special emphasis (placing, red or bold lettering) en bloc with the other clauses of these General Commercial Terms.

4/ In the CMEA countries there do not exist any ICC regional groups.

from lists of national committees as well as the procedure of confirmation of arbitrage awards - is regarded by the GDR enterprises as having a too far reaching influence on ICC arbitrage. That is why that kind of arbitrage is agreed upon only in exceptional cases.

Generally speaking, it may be stated that in most contracts general trading terms for the purchase of goods and methods of settling disputes are not separately negotiated.

The printed clause in the general trading terms is accepted as part and parcel of the contract. Exceptions of the type mentioned here only confirm its regularity. Should a litigation become necessary, the plaintiff may still petition the 'agreed' arbitration court and achieve a commercial clarification (outside the arbitration court) of problem which has arisen.

Contracts on plan and equipment, co-operation contracts etc. are regularly negotiated. Extensive text contracts stipulate ways and means of implementing, amending or adapting the contract and sanctions for inadequate fulfilment. General trading terms do not apply, except as a possible subsidiary measure.

Questions of the application of law and the settling of disputes are explicitly negotiated. There, apart from the close link between the two clauses, a correlation between them and the terms of the contract manifest itself through price, guarantee and warranty. The settling of disputes is transformed into a specific and individual matter of the concrete contract relation and the concomitant interests of the contracting partners. Furthermore, there clearly appears, in view of the long-term character of the contractual relation, the need for arbitrage and for applying the entire mechanism of dispute settlement to help avoid litigation.

The settling of disputes here is understood in a more comprehensive sense and includes measures for adapting and supplementing contracts. The Law of February 5, 1976,[1/] on International Commercial Contracts (GIW, which was especially passed to meet the requirements of the international commercial relations of the GDR, complies,

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1/ Law Gazette 1976. Part I, No. 5, p. 61, also cf. Dietrich Maskow, Hellmut Wagner et al, Kommentar zum Gesetz über Internationale Wirtschaftsverträge, Staatsverlag der DDR, Berlin 1978.

to a large extent, with the expansion of the scope of tasks incumbent on arbitrage.[1/]

The Chamber of Foreign Trade of the GDR recommends to the GDR enterprises negotiating arbitration clauses in text contracts to consider first the permanent arbitration court attached to this Chamber of Commerce. The possibility of agreeing on a permanent arbitration court in a third country (either in a non-socialist country or in Finland, Sweden or Austria) is also pointed out. Attention is drawn to the CMEA scheme as a model: the competence of the permanent arbitration court in home country of the defendant[2/], a principle on which the agreements on the joint recommendation of a coordinated arbitration clause are concluded between the Chamber of Foreign Trade of the GDR and corresponding institutions of the non-socialist economic sphere. Finally, reference is made to the manifold possibilities of arbitrage ad hoc and the usefulness of referring to ECE or UNCITRAL Arbitration Rules including an agreement on an Appointing Authority.

1/ The adaptation of contracts has been given a special regulation in the laws of the GDR by Art. 295 GIW. It applies to the case that for attaining the purpose of the contract, vital circumstances, from which the parties proceeded when concluding the contract but which exceed the possibilities of their influence, changes so fundamentally that the parties, should they have been aware of such changes, would not have signed it. According to Art. 296 GIW the parties may, under their own responsibility, agree upon an adaptation of the contract to the changed circumstances. Should too agreement be reached, the party affected by the change occurred is entitled to cancel the contract. Between the two corner points - agreement and cancellation - there lies, however, a certain margin which makes the intervention by a court of arbitration appear sensible.
By means of declaratory judgment proceedings the arbiters may, by themselves or with the aid of further experts, ascertain whether and/or what fundamental changes in the circumstances of major importance for the contracting parties have occurred. Many matters require examination: the changes themselves, the impact on major circumstances, the casuality in relation to the bases of the contract etc.
In accordance with the contents of arbitration clause the arbiters may go one step further and, by weighing the interests of the parties on the two principles clausula rebus sic stantibus and pacta servanda sund, submit proposals for measures of adaption.
Again, depending on the arbitration clause, these proposals either replace outdated contractual terms or form the basis for new direct negotiations between th contracting parties within a stipulated time after its unsuccessful elapsing a cancellation according to Art. 285 still remains as ultima ratio. That adaption brought about with the aid of arbiters already extends into the sphere of supplementation of a contract.
Art. 42 GIW provides for the (arbitration) court's Supplementation of a contract, meaning the supplementation of the contract in the case of certain circumstances occurring. The (arbitration) court thereby operates shaping the contract.
This supplementation of the contract, regulated by Art. 42 GIW, is not only coupled with the adaptation of the contract, but has also significance for the filling in of gaps in the contract which both parties, when concluding the contract, had consciously taken into account in the expectation of being able to close them through additional agreements after gathering further experiences, information, etc.
In this connexion two cases may be distinguished. In the first case, the parties proceed from the expectation to be able to close the gaps themselves. They require assistance by the (arbitration) court should their own independent efforts fail. In the second case, the contracting partners agree, a priori, to fill in the gaps through a third party (Art. 42 GIW). The special feature of the legal provision provided by GIW consists of the fact that the third party, that determines the lacking contract terms may, in the final analysis, be a state court or an arbitration court. In this way, the legal basis of arbitrage is considerably extended.

2/ Actor sequitur forum rei: this principle applies to relations between economic organisations of the CMEA countries from the very beginning and was once again stipulated in the Moscow Convention 1972.

Practice has even more variations than the orientation provided in contracts and publications of the Chamber of Foreign Trade of the GDR.

The dependence of the arbitration clause on other stipulations of the text contract excludes the possibility of enforcing settlement of a dispute at any cost, in a verbal or metaphorical sense. As in the general contract, the litigation clause is a compromise. Occasionally even clauses inconvenient to one of the parties or a concealed proviso not to use the agreed method of settlement will be signed. Such an exceptional situation will, above all, arise if the clause, at least in the view of one contracting partner, has not been sufficiently coordinated with the clause on the application of law or if the latter is lacking altogether. The contracts referred to here are too significant and generally too valuable to leave the question of dispute settlement unanswered. Particularly in relations to developing countries, the negotiation on the clause of what law is to be applied sometimes causes difficulties. Our knowledge of the national legal systems of, for example, African and Arab countries, is still partly limited. It appears that the law concerning commercial relations, especially international commercial relations, has not yet been sufficiently developed. Therefore, the legal position and the outcome of the court proceedings cannot be sufficiently understood or predicted by the foreign contracting partner. Such uncertainties influence agreements on the law to be applied and impair negotiations in the clause for settling disputes.

An additional problem results in business relations with developing countries in Africa and Arabia when the GDR enterprises encounter an organ of the country as contracting partner, such as the Public Works Department, the State Council, the Ministry of Public Education or the Ministry of Health, which would like to insist that no outside laws be applied to their activities.[1/] They should like to ensure that as up to now only domestic courts deal with litigation. Occasionally they are prepared for arbitration ad hoc provided the venue of the court is located in their own country. Such difficulties can be overcome only gradually through bilateral trade agreements which constitute, from the viewpoint of the CMEA countries, an effective strategem for the setting up and safeguarding of mutually favourable conditions for the implementation of contracts including the settling of any litigations.

The contractual practice of the GDR enterprises aims to:

- accept contracts, on the basis of General Commercial Terms, which include a clause for settling disputes, in most cases through arbitrage, particularly since no real possibility of negotiating all individual contractual provisions and clauses is feasible and/or customary.

1/ The International Law Association has, in its Committee International Commercial Arbitration for many years been dealing with the problems arising from relations between enterprises on the one hand and government institutions on the other hand. Cf. the reports made by Committee Chairman Martin Domke and the corresponding papers published in the ILA Congress Reports.

- In the case of text contracts, the clause regarding the settling of disputes is coordinated with clauses on the application of law, on price, terms of payment, warranty, guarantee etc. Its isolated consideration does not increase its value in the final contract.

The Chamber of Foreign Trade of the GDR lends its support to the enterprises by pointing out effective and juridically secured arbitration clauses. Adapting these suggestions to the individual situation is the enterprises' responsibility.

CHAPTER 3: PROPOSALS FOR IMPROVING THE SYSTEM OF THE MECHANISMS FOR SETTLING OF DISPUTES

The primary significance of negotiations on dispute settlement clauses lies in the text contracts, such as contracts concerning the supply of plant and equipment; contracts on planning, supply and erection; all kinds of co-operation contracts: contracts on scientific technological performances; or as a rule, any complex matters and long-term contractual relations. The previously mentioned integration of clauses into the overall contract, excludes making any one dispute settlement method absolute. It is, however, necessary to introduce those taking part in international business relations the entire multitude of methods and to convey to them how they might deploy specific methods in adapting and supplementing contracts as well as in asserting claims in case of inadequate fulfilment of a contract. Then it will be easier to ascertain disputes typical of the contract and the method of settlement, and to agree on the method in a contract.

It cannot be expected that the CMEA countries' appreciation and use of arbitrage as the most adequate method of settling disputes in international economic and scientific-technological co-operation, can be duplicated in the near future within the inter-system (universal) business relations, but steps in this direction are feasible. They include:

- propagation of the steps outlined in Chapter I for the construction and expansion of an internationalistically conceived, nationally organised arbitrage in the CMEA countries, including the legal foundations established on a national basis as well as through co-operation between these countries as example of a regional system of arbitrage which can be adapted to the manifold forms of international co-operation in the field of arbitrage;

- propagation of the idea of arbitrage as set out in the four International Conventions of 1923, 1927, 1958 and 1961 in the developing countries which take a reluctant or negative attitude to the internationalistically-oriented arbitration system; the success of that propaganda depends to a large extent on how to counteract the political and socio-economic causes of such prejudices (sovereignty of the state, sole competence of the domestic state courts; Calco-clause/sole competence of domestic state courts and arbitration courts);

- foregoing of legislation in certain developing countries which are based on traditional legal concepts and prove themselves in present day practice as inimical to arbitration, such as the legal possibility in India, in contradiction to the clearly expressed will of the contracting parties and the text of the arbitration clause, to refer the matter under dispute to the state court and to decide it there;

- enhancing the attractiveness of arbitrage by improving its international legal basis, such as a legal combination of the two UN Conventions of 1958 and 1961 and setting up the legal institution of the international arbitration award with an internationally standardised regime as to legal effect, recognition and enforcement;[1/]

- continuing the work initiated by UNCITRAL in consultation with ICCA for the creation of Uniform Conciliation Rules.

It seems sensible to set up gradually national arbitration centres in developing countries which are active in international business relations, e.g. in India. National chambers of (foreign) commerce or associations of businessmen, enterprises and institutes interested in a permanent arbitration court would be suitable members. The regional organisations of UNO could render relevant assistance as well a. AALCC. The existence of national arbitration centres in the developing countries:

1/ The New York Convention does not eliminate the difference between domestic and foreign arbitration awards. Such differences, however, exert an effect particularly in the recognition and enforcement of arbitration awards and also occur in connexion with the rescission of arbitration awards. Correspondingly the differentiation between domestic and foreign awards is of considerable juridical relevance and practical significance. According to ruling concepts an award shall be regarded as foreign if it is based on the laws of a foreign country either on account of territorial connexion (seat of the arbitration court, venue of the proceedings), or because of the application of the procedural regulations of that country to the arbitration proceedings.
In the past there have been numerous endeavours to circumvent looking for internationally uniform criteria for the domestic or foreign character of an award and the concomitant different legal consequences by introducing the legal concept of international award. Thus the International Chamber of Commerce (ICC) Paris 1953 submitted the elaborated draft of an international agreement by the name of "De la reconnaissance et l'execution des sentences arbitrales internationales" for treatment by the Economic and Social Council of the United Nations (ECOSOC). This scheme was meant to cover all awards arising from commercial disputes which arise:
- between persons subject to the jurisdiction of different countries, or
- from juridical relations which are realized in the areas of different countries.
If such a Convention had been accepted and spread world wide to all cases of significance in international business relations, the distinction between domestic and foreign awards would have been replaced by the differentiation which facilitates handling, between domestic and foreign arbitration awards.
The realization of that proposition would have entailed the extension of the Convention to domestic arbitration awards arising from international commercial disputes. This would have created a really international uniform special juridical regime for the arbitration awards arising from international business relations. When assessing the importance of such a step the fact should be taken into account that a number of legal systems causes great difficulties in the implementation of domestic arbitration awards (registration, taxes, checkability, confirmation by the courts and the like) as well as the generally reported principle that it is easier to enforce a domestic award than a foreign one, does not apply in many places. International legal developments have embarked on a different road. The legal concept of international awards does not yet exist. The New York Convention which was published on June 10, 1958, as a result of the deliberations of the Economic and Social Council of the United Nations (ECOSOC), deals, as its name indicates, only with foreign arbitration awards, so that the questions of the "nationality" of the arbitration award is still left unanswered.

- leads necessarily to spreading the idea of arbitrage in those countries;
- establishes starting points for co-operation with such centres, including joint recommendations of certain arbitration clauses;
- develops with the partners of the developing countries an atmosphere of confidence in the legal protection of their interests, making it easier for them to consent by contract to dispute settlement in the developing countries.

The deliberations regarding the establishing of an international arbitration centre (UNIDO arbitrage) are not meant to put aside or replace measures for the setting up of national arbitration centres in the developing countries but to be supplementary measures in order to obtain the range of variants required for selecting the method of settling disputes which is appropriate for contracts.

The existing international centres apparently are not suited to handle the tasks which are intended for UNIDO arbitrage. ICSID is too closely linked with the World Bank and IMF and, in spite of the brilliancy of its procedural rules,[1/] politically one-sided. Similar considerations apply to ICC arbitrage which, however, is no international arbitrage in the legal sense. The Permanent Court of Arbitration in the Hague is endeavouring to become involved, in addition to its original tasks, in the same direction as ICSID[2/] with which it maintains close contacts. Because of its main task, which permeates the entire organisation, and, above all, owing to its composition, the Permanent Court of Arbitration is obviously not in a position to make itself attractive to the developing countries in a global commerical arbitrage. Therefore, the idea of a UNIDO arbitrage has chances of succeeding Its organisational form is still of secondary importance. We can conceive of an administration centre with a comprehensive information and documentation section and an educational or training centre at a geographically suitable place with regional secretariats, connected with ESCAP, ECLA, ECA, ECE and national secretariats linked with the national arbitration centres which organise arbitration proceedings and fulfill all the tasks of Appointing Authorities and Administering Bodies by maintaining lists of experts.

1/ Aron Broches, Arbitration under the Auspices of ICSID, Seminar on International Commercial Arbitration, Madrid, October 16/17, 1978; Aron Broches, The International Centre for Settlement of Investment Disputes, in: E. Cohn, M. Domke, F. Eisemann, op. cit.

2/ Rapport du Conseil Administratif de la Court permanente d'Arbitrage, La Haye 1978.

The close link between the settling of disputes and the issues of the law to be applied makes it desirable that the developing countries exert still greater efforts to establish a contractual legal system for international business relations. This can be done by further developing the national legal system and more so by taking an active part in drafting international regulations such as the Convention on International Purchase of Commodities (UNCITRAL). A similar situation prevails in the sphere of international civil law. No information, based on exact legal provisions, jurisdiction and literature, exists on how the individual developing countries determine what laws apply to contracts and, if such a choice is lacking or not recognised, to ascertain what material law should be applied. This insufficient knowledge proves itself a hazard for the foreign business partner. To minimise such a risk it is suggested that in contract negotiatons the established legislation of another country be employed.

By establishing and further developing national legal systems in the developing countries, particularly by creating a contractual law which meets the requirements of international business relations and/or intensified participation on international projects for the standardisation of legislation, such as within the framework of UNCITRAL, the developing countries facilitate contractual negotiations on the law to be applied.

By setting up national arbitration centres and by co-operating in a genuinely international arbitrage system, such as e.g. a UNIDO arbitrage, the developing countries create preconditions for the possibility of:

- changing gradually over, when choosing means for settling of disputes, from the state courts to arbitrage;
- providing in international commercial contracts depending on the circumstances, the settling of disputes through arbitrage in the developing countries;
- concluding co-operation agreements with corresponding institutions of other countries, such as Chambers of Commerce and Industry of the CMEA countries, in the field of arbitrage, including the recommendation of model arbitration clauses;
- propagating at international events and seminars within the UN system, international arbitration congresses etc., legislation and arbitrage of the developing countries; expert information will help eliminate psychological barriers which prevent companies of the developing countries from rejecting stereotyped agreement based on European law and settlement of disputes by an arbitration court outside their own region.