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International Economic Development and the Illusion of Legal Certainty

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adverse effect, in the long run, upon the ability of underdeveloped countries to secure public money from governments of countries whose private investors complain about the matter.

Numerous techniques have been advocated for dealing with this complex, ranging from ambitious investment codes of behavior to which host countries are desired to conform, through a variety of arbitral or litigative techniques designed to provide more adequate remedies for state action which injures investment, to reassessments of the international legal ideas of just compensation, and to the newer, postwar national and multilateral investment guaranties which insure against risks which eventuate. These and perhaps others will be discussed in the setting of the social change and accompanying conflict which we see about us.

The CHAIRMAN then introduced the first speaker, Professor A. A. Fatouros of the Faculty of Law, University of Western Ontario.

INTERNATIONAL ECONOMIC DEVELOPMENT AND THE ILLUSION OF LEGAL CERTAINTY

BY A. A. FATOUROS

Faculty of Law, University of Western Ontario

It is, no doubt, a commonplace to assert that we are living in an age of revolution. Commonplace or not, it is true. This is an era of rapid change on all levels: cultural, economic, technological, social, political and moral. It is clear that deep social conflict marks both the international and the national scenes. The world has always been divided into rich and poor countries, but it is only recently that the poorer states have acquired political significance in international affairs, that their voice can be heard and their influence felt in the councils which were formerly restricted to the great Powers of Europe and North America. The division of the world into "haves" and "have-nots" is playing an increasing rôle on the international scene, a rôle which is already more important than the ideological division into East and West. When discussing the problems of international economic development, it is useful to keep this fact in mind. After all, but for this increasing importance of the "have-nots," we probably would not have been discussing the present topic today.

I intend to start my discussion by stating certain basic propositions which I shall treat as the assumptions underlying my approach to the problem with which this panel is dealing. I do not mean that these propositions are not open to question; they certainly are and I am prepared to discuss them, if need be. For present purposes, however, it is more convenient to state them in this manner.

My first assumption is that international economic development and, in particular, the development of the now backward regions of the world, is a policy objective of first magnitude for all members of the world community, and this includes states, developed and underdeveloped, as well as

private persons, individuals and companies. A second assumption is that the process of development will have to start immediately and it will have to reach a satisfactory level, meaning a largely self-sustaining level, within a relatively short time, say within the next two or three decades. So that, in what follows, economic development means speedy economic development. I am assuming further that it is possible to separate, for purposes of study and analysis, the problems of the cold war from those of economic development. This, of course, is well-nigh impossible at the final policy level.

The last proposition I should like to state is that private foreign investment is today necessary, even if not by itself sufficient, for the speedy development of the less developed countries. On this point various opinions have been expressed lately. They range from advocacy of the total abandonment of private foreign investment in the less developed countries to support for the view that private capital can by itself assure the development of these countries. I shall not discuss these views here, apart from stating that I assume both to be wrong. They may be brought up later, of course.

These "assumptions" have already made fairly evident my basic approach in this paper. What I am concerned with here is not the "protection of foreign investment" nor the safeguarding of the so-called sovereign rights of capital-importing countries. I am concerned with international economic development and the rôle of private foreign investment in it. From this point of view, the security of private foreign investment is not a value in itself, but is valuable to the extent that it is necessary for development. Its necessity cannot be denied, since some degree of security is a precondition for future foreign investment in the less developed countries. On the other hand, the approach here advocated is, I submit, a useful one, in that it tends to put the various relevant considerations into perspective. If protection of foreign capital were the basic consideration, then the best remedy is already in the hands of private investors. Foreign investors, in most cases, do not have to invest in developing countries. They can then assure the security of their investments by investing only in those, usually already developed, countries which offer full assurances of protection (in fact, the majority of investors do just that). On the other hand, if complete safeguarding of the national economy from foreign interference were the only desirable aim, the governments of less developed countries could easily refuse to accept foreign investments and try to do without them. On both sides, the remedies for the realization of such extreme positions are already available (in the long run, at least, if not always in the short). An approach which focuses on international economic development, however, tends to reject both extreme positions as irrelevant. From this point of view, the problem is how to bring these at first glance contradictory positions together, how to arrive at a compromise which will make possible speedier economic development. And this can only be done, in the final analysis, under conditions which are acceptable both to the peoples (and the governments) of the less developed countries

and to the aliens who are willing to risk their capital in these countries.

Inside the less developed countries the drive for economic development is bound to bring changes which are revolutionary in character. What we call "economic development" is by no means solely economic in character; it is in fact a vast process of social, cultural, political and economic change, whose exact causes, order of sequence and effects we still do not know with any degree of certainty. It is precisely because it involves such extensive change, that economic development has captured the imagination and faith of millions of people. At the same time, no such extensive change can be painless or easy.

Perhaps because of the influence of official phrases and descriptions, we tend sometimes to visualize this process in highly idealized terms: we see masses of men fired by a common ideal and working wholeheartedly, in close co-operation, for the achievement of their high purposes. We of the Western countries should know better. We should be aware that social and economic change is neither sweetly pleasant nor peaceful. It is a painful and difficult process which involves destruction as much as constructive effort; the serenity and beauty of immemorial custom are replaced by the ugliness and the often meaningless agitation of new methods, yet untried or slavishly imitated from other cultures; the energies which are liberated may work for bad as well as for good. After centuries of relatively peaceful and slow evolution, the Western countries still have many unsolved problems, many conflicts and show much lack of understanding of themselves, their neighbors or more distant cultures. How can we then expect the peoples of the newly emerging states to have already resolved their far more basic and difficult problems (some of which we may have had a hand in creating, but let us not go into that) and to offer to the outside a calm and forgiving attitude? This is not pleading for charity or tolerance on the part of the West; it is stating the need for intelligent understanding and consequent adjustment.

The situation in the less developed countries today constitutes a challenge to our traditional conceptions of public international law. While no single general description can be given which would be valid for so many countries with so many cultural and political backgrounds, certain common patterns are to be found in most of them. What strikes one the most is a certain basic instability, a precariousness in their internal conditions. Their problems are so immense, their objectives so distant, that one cannot see how the present situation can continue for a long time without a breakdown or without a fall into some form of complete anarchy.

In the less developed countries there prevails today an atmosphere of constant "public emergency" comparable to that which exists in the developed countries of the West during a war. Several points of similarity may be noted. The country's economy is administered in both cases by a state bureaucracy with extensive powers of direct and indirect interference. The borderline between matters of public and of private concern tends to be confused, if not eliminated. Economic and other problems are looked at from a peculiar dual viewpoint of efficiency, on the one hand,

and national honor and prestige (you may call it propaganda), on the other. An atmosphere of crisis prevails. Every success or failure in the drive for development (as in the war effort) assumes an exaggerated importance. Governments (and, to a varying extent, the people behind them) lack patience with delays or tolerance for mistakes which may endanger the success of the economic development effort. There is even less tolerance for outright refusals to conform with the state's policies on such matters. In essence, there is little desire for compromise, little recognition of the necessity to give in now in order to gain something later. Despite pious references to long-run considerations, it is the short-run that governs. Wherever action is involved, governments feel that they cannot afford to wait for the effects of long-run policies.

To describe these attitudes is not to defend them. No doubt, emotion often obscures the realities that judgment ought to calmly consider; what is demanded is sometimes impossible, the policies so furiously defended are often wrong, the points of dispute are sometimes trivial and, with a little patience, could easily have been resolved. The fact is, however, that economic development is for the less developed countries a matter of survival, an issue as vital as any question of war and peace. We may regret some of the attitudes caused by this sense of urgency, but we have to take them into consideration and treat them as given in order to be able to plan and act effectively.

The consequences of this situation with respect to private foreign investment are too well known to need detailed exposition. Investments in the less developed countries necessarily involve a high degree of risk, to start with, in view of the state of the economy, its instability and lack of balance. To these unavoidable economic risks, new risks are added: the laws and policies under which the foreign enterprise is going to operate are far from certain, the prevailing attitudes and prejudices import new elements of instability and uncertainty. The difficulties of the present situation become readily apparent when one attempts to determine with any precision the remedies available to investors in the case where the government of the country of investment takes measures which, whether directly or indirectly, affect adversely the investors' interests. In this case, and in any other case where a serious dispute arises between the foreign investor and the host government, the former finds that he cannot be certain of the effectiveness of the legal remedies he has. Before considering, however, the degree to which this is true (and that it is true to some degree is undeniable), I should like to direct your attention to certain other considerations.

Most of the discussions about foreign investment and its legal security center on the remedies available to foreign investors in case of dispute and on their effectiveness or lack thereof. It is my submission that this approach is insufficient and even misleading. By focusing our attention on the formal possibilities of recourse open to investors in what are, after all, exceptional situations, namely, those of major disputes with the host government, we are losing sight of the complete picture. In order to

ascertain the degree of certainty within any legal order, the order as a whole should be considered. If attention is directed only to disputes and their probable solution, a relatively high degree of uncertainty is bound to be noted, even within the stable societies of the Western states. The exclusive concern with the lawfulness or legality of particular measures is as out of place in international economic relations as it is in international politics. Not because law is irrelevant or unimportant, but because the question itself, "Is it lawful?" is meaningless when taken out of its particular context. It is only by looking at the legal order as a whole, in its economic and political context, that we are able to perceive the degree of legal certainty which obtains in fact.

The evolution in the forms of foreign investment is of some interest in this connection and it is, I submit, quite instructive. In the nineteenth century and the first three decades of the twentieth, the prevailing form of foreign investment in the then developing countries was portfolio investment. The governments of these countries would float loans in the capital markets of London, Paris or New York to finance their road or railway building or, sometimes, their current budget expenditures. They often over-extended themselves and they had difficulties in keeping up the service of their debt; they consequently tried to extricate themselves through various measures, on the legal aspects of which a vast literature soon amassed. The financial crisis of the thirties (as well as certain other developments with which we cannot deal here) put an end to the problem: it has become virtually impossible for most of the less developed countries to raise any considerable amount of capital through the flotation of loans in foreign capital markets. Incidentally, this has also led to a marked decline in the output of juristic literature on public loans, a fact which perhaps proves that jurists keep in close touch with economic and political realities.

The form of foreign private investment which prevails today is direct investment, that is, investment in enterprises operating in foreign countries. Now, it is obvious that direct investment entails a much higher degree of involvement in the host country's economy than does portfolio investment. It would then appear, at first blush, that such investment, far from being safer than portfolio investment, is subject to additional dangers and is, therefore, more insecure. It would thus seem paradoxical that direct investment prevails today in the international scene precisely because of the lack of security for portfolio investment. The paradox persists if one considers the remedies available to investors in the two cases; though, in the case of direct investment, the investor appears to have somewhat more numerous and effective remedies, the difference is hardly of sufficient magnitude to explain the prevalence of this form of investment. The paradox is only explained when one considers certain other differences between the two forms. In the first place, the two are undertaken by different classes of investors; in contradistinction to portfolio investment, direct investment is undertaken by entrepreneurs, men whose very business is to take risks. In the second place, direct investment involves a

higher degree of choice and, of course, of control. The investor does not choose merely between lending or not lending his capital, he chooses between several alternative sets of conditions for investing and he retains, after the investment, a high degree of control over the policies and operations of the enterprise. Furthermore, he can count in most cases on the concrete effect on the economy of the country of investment of the operation of his enterprise and this gives him considerable bargaining power. The capital he invests is only part of his contribution: the industrial know-how or the possible control of outlets for the sale of primary products are at least equally important. These factors, together with the higher rate of return that direct investment offers, tend to compensate for the additional risks.

This short and unoriginal excursion in the history of foreign investment shows clearly that the foreign investor has, with respect to direct investment, a considerable amount of choice both at the very beginning and during the operation of his enterprise and it also shows that this fact is of paramount importance. Legal considerations should be brought into play at these points, too, not only with respect to possible disputes with the host government. Is it really necessary to stress, before an audience of American lawyers, the importance of the preventive and advisory rather than the remedial rôle of the lawyer? At the time of the establishment of the enterprise in the foreign country, law and the lawyer's trained ingenuity should play a most important rôle. It would be desirable to establish openly a pattern of continuing interlocking relationships, legal and economic, between the investor and his enterprise on the one side, and the government and the economy of the country of investment, on the other. It is clear that it is not enough to seek an initial good bargain. It is far more important to provide in the basic documents (whether contracts or administrative orders) for ways of communication between government and investor which can be kept open even at a time of crisis. It is preferable for the investor to recognize, at the very outset, that his investment and the future operation of his enterprise are matters of public concern for the capital-importing country and to arrange from the very beginning for the ways in which this concern will be expressed. And jurists can profitably devote their time and ingenuity to the creation of new forms and methods of association making operative and evident the interdependence in each particular case of the interests of the foreign investors and the capital-importing countries.

Flexibility is needed in choosing the form of investment, the kind of enterprise, or the method of financing. The creation of joint ventures with local private or public capital, is one kind of solution to these problems (and in this connection it is only necessary and sufficient to refer to the monumental study of *Joint International Business Ventures* prepared under the direction of Professor Friedmann). Association with foreign public capital, from international or United States financial institutions is another possibility; such association will generally provide additional security to the investor. Another possibility is the undertaking of specific obligations

relating to matters of public concern, such as the training of nationals of the host state, the provision of certain basic facilities, co-operation with the host government or with international agencies in specific development projects in the foreign enterprise's region of operation, even if these projects are not directly related to the main purposes of the enterprise. These are not theoretical propositions; they are descriptions of obligations which have in fact been undertaken in many instances. The basic element is the provision for arrangements which will have to be implemented throughout the operation of the enterprise. The continuing character of the relationship is thus made evident.

It cannot be denied, of course, that, in spite of all legal and economic arrangements and in spite of all good advice to the foreign investors or the foreign governments, differences are bound to arise. There exists today an urgent need for devising and applying methods for the orderly settlement of any such disputes. In the long run, such orderly settlement will benefit both the foreign investors and the less developed countries. There have been recently repeated suggestions for the formulation of an over-all set of principles applicable to the relations between them. One basic problem is that there is no over-all agreement on the identity and content of these principles. In fact, such principles have not yet been fully elaborated; they still have to be found, formulated and accepted by a majority of the members of the world community. Other recent proposals suggest the creation of a system of arbitral tribunals to which all investment disputes would be referred. I have suggested elsewhere that at this stage, at least, the proper method for settling disputes between governments and foreign investors is conciliation rather than compulsory arbitration. I may summarize my argument briefly:

The conflicts between foreign investors and the states of investment are not due basically to disagreements over the legal rules applicable. They are caused by the demand of the "new" states for a reappraisal of the existing legal and economic relations and for the establishment of new legal rules to govern these matters. The situation is comparable to that of labor law in late nineteenth-century Britain; what is involved now (as it was then) is not the elucidation of the existing legal rules, but their change through legislation. On the international scene, it is well known that arbitral tribunals tend to be judicial in character, allocating to themselves at most an interstitial legislative rôle. Today, this is not sufficient, because the needed changes in the law are too far-reaching. In the absence of an international legislature, the best way in which the existing rules or relationships can be changed is through the agreement of the parties. And conciliation provides the institutional framework for bringing together the parties to a dispute and suggesting concrete solutions, founded on all relevant considerations, economic and political as well as legal. Such a procedure will then assist in the solution of particular problems and disputes and, secondarily, in the creation of tentative new rules founded on the concrete solutions of several similar disputes.

It is true that some disputes will not be capable of being resolved in this

manner. With respect to investment problems as well as other international problems, it is true that no method can guarantee the solution of all disputes. It is better to accept this as an unpleasant fact rather than attempt to uphold strict rules of law by divorcing them from reality. Such a process would give us at best but an illusion of legal certainty where no certainty really exists. No investment code in the world would have affected the evolution of the situation in Cuba. And if Dr. Castro's regime is overthrown, no protestations of international legality and the binding force of contracts are going to stop its democratic successor from severing its commercial ties with the Soviet Union and China, if it wishes to do so. We should then try to solve those problems that can be solved and to diminish the unpleasant consequences of those that stay without a solution.

The traditional body of public international law can be of considerable assistance in all this. First of all, extensive use can be made of its institutions, political, economic and judicial. Secondly, it constitutes a most useful repository of methods, techniques and general principles which can be applied by analogy to the relations between foreign investors and host governments. As far as specific legal rules are concerned, international law can only provide an external framework of rules to which recourse can be had in extreme situations. In a sense, this is the traditional approach to the subject, the approach stressing the existence of a minimum standard of treatment of aliens, with the emphasis on that first word, minimum. Obviously, a minimum standard is not an ideal one, nor does it even describe a desirable method of treatment; it only determines the outside limits of the tolerable. In matters of the treatment of the person of aliens, judicial procedures and the like, this function of the minimum standard of international law is clear; its requirements are certainly much lower than those in effect in the domestic legal order of most developed democracies. With respect to property matters, however, what is sometimes referred to as a "minimum standard" is often a description of the treatment of private property in the most property-conscious of the Western democracies. A similar difference in the conception of the proper rôle of international law rules underlies the current controversy regarding the legal effects of state measures affecting foreign interests founded on a contract with the host government. It has been suggested, as you know, that such state measures constitute an international wrong, unless they are specifically justified on the grounds of national defense, criminal law and the like. The more or less traditional view of the matter, which I myself support, holds that an international tort arises in such cases only after a subsequent denial of justice or where the state has manifestly abused its rights. Since in most cases of importance a denial of justice is likely to arise, this insistence on its presence may appear to constitute mere quibbling. The usefulness of such insistence, however, lies in its making evident the proper rôle of international law rules in such matters, namely, that they should be invoked as a last resort in exceptional circumstances.

It may be that in stressing the need for flexibility and ingenuity, great emphasis has appeared to be laid on the actions of investors, while the attitude of the less developed countries seemed to be taken for granted. To a large extent, this is accidental; there is no doubt that the states of investment should also show a high degree of flexibility in order to take the maximum advantage of existing opportunities for development. A flexible arrangement is usually flexible on both sides. There are in fact many indications that the less developed nations are not generally taking an abstract doctrinaire stand on matters of foreign investment, but prefer to work out specific arrangements founded on a basic flexible position. This lack of "hard and fast policies" has been convincingly described in Professor Lissitzyn's recent study of "International Law in a Divided World."

It has to be admitted, however, that there is something more to this emphasis on the actions of investors rather than host governments. It has been my assumption that international economic development is to the advantage of both the developed and the less developed countries. But it is the developed that will have to make the first steps toward the underdeveloped; the "haves" will have to show the "have-nots" that they are capable of sacrificing some temporary advantages in order to better achieve the common goal. Foreign aid is obviously the clearest manifestation of such an attitude, but similar considerations, applied in different manners and probably to a less extent, also obtain in the field of foreign investment. It is a psychological fact of life that he who is in a stronger position for the time being must be the one who will have to show first that he does not intend to exploit his position, in order to induce the weaker party to stop defending itself and start moving toward the common goal. Again, I am not talking in terms of charity and benevolence; what I am referring to is something that most businessmen are prepared to do and are doing in more familiar contexts, not for the sake of their souls, but because it is useful and convenient. An additional consideration is that it is the investors and not the states of investment who possess the resources of experience and skill which are needed for devising the arrangements to be established. This is in effect part of the know-how they will be importing into the less developed countries.

I am well aware of the fact that this paper fails to offer a simple, concrete solution to the problems we are considering. My propositions are hedged with "ifs" and "however," my statements are qualified over and over again (and I can assure you that I have omitted several qualifications that I could and should have added). How is a businessman to act, or a lawyer to advise, in such a situation, where no certainty is in sight, where so many variables are of essential importance? But the present world situation in the field of foreign investment is complex and contradictory. It cannot be changed by merely wishing it were different. It would be of little use to present to you an ideal system which could not possibly be put into practice. No one can deny our need for legal certainty at the present time; but certainty has to be founded on reality, if it is to be more than an illusion.