Public Disclosure Authorized

FILE COPY

Report No.:11415 11415
Title: LEGAL FRAMEWORK FOR THE TREATM
Author: WORLD BANK
Ext.: 0 Room: Dept.:
2 VOLS BOOKSTORE 1992

Legal Framework for the Treatment of Foreign Investment

VOLUME II: Guidelines

Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment

FILE COPY

Public Disclosure Authorized

The World Bank Group

LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT

Volume II

Report to the Development Committee
and
Guidelines
on the Treatment of Foreign Direct Investment

Prepared by the
General Counsel of the World Bank
(the International Bank for Reconstruction
and Development and the International Development
Association), the International Finance Corporation
and the Multilateral Investment Guarantee Agency
and submitted to the Fall 1992
meeting of the Development Committee of the
Boards of Governors of the International Monetary
Fund and the World Bank which on
September 21, 1992 discussed the
Report and called the Guidelines
to the attention of member countries.

© 1992 The International Bank for
Reconstruction and Development/THE WORLD BANK

LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT

Volume II

Report to the Development Committee
and
Guidelines
on the Treatment of Foreign Direct Investment

CONTENTS

Foreword

For the first time, the world community found it appropriate last year to ask the World Bank Group through the Development Committee to prepare universal standards for the legal treatment of foreign direct investment. This task has now been completed and the Development Committee has agreed in its September 1992 meeting without reservation to call the guidelines prepared for this purpose to the attention of our member countries.

This publication includes the text of these guidelines and the detailed report which explains that text. It should be of great relevance to the continuous efforts in our member countries to improve investment climates and facilitate greater investment flows. The guidelines may also assist in the progressive development of international law in this important area.

Lewis T. Preston

Lewis T. Preston
President
World Bank Group

September 25, 1992

Introductory Note

In April 1991, the Development Committee, which is a Joint Ministerial Committee of the Boards of Governors of the International Monetary Fund and the World Bank, requested the Multilateral Investment Guarantee Agency (MIGA) to prepare a "legal framework" to promote foreign direct investment. Realizing that this was a matter of interest to all World Bank Group institutions, the President of these institutions assigned the project to a small working group consisting of their General Counsel and asked me to chair this group.*

The approach followed by the task force was described in a Progress Report submitted to the April 1992 meeting of the Development Committee and published in Volume I of the *Legal Framework for the Treatment of Foreign Investment*. The Report explained that the World Bank Group could not issue binding rules to govern the conduct of member States in this or other fields. A draft convention could of course have been prepared and opened for signature by interested countries. The working group however found it more advisable at the present stage to prepare a set of *guidelines* embodying commendable approaches which would not be legally binding as such but which could greatly influence the development of international law in this area in view of their preparation by organizations of universal membership after broad consultations and their eventual issuance by no less an authority than the Development Committee.

First drafts of the guidelines and of their accompanying explanatory report were circulated to the Executive Directors of the World Bank, IFC and MIGA in May 1992. Extensive consultations followed with the Executive Directors, as well as with other representatives of interested member countries, intergovernmental organizations, business groups and international legal associations. In the consultations, it became clear that certain clarifications and modifications were necessary or desirable. These were incorporated into the text but did not fundamentally change its basic balance.

The resulting guidelines cover each of the four main areas usually dealt with in investment treaties, namely the admission, treatment, and expropriation of foreign investments and the settlement of disputes between governments and

---

* Original members of the working group included Ibrahim F.I. Shihata, Vice President and General Counsel, World Bank, José E. Camacho, Vice President and General Counsel, International Finance Corporation (IFC) and Luis Dodero, General Counsel, MIGA. In fact, the working group also included Daoud L. Khairallah, Deputy General Counsel, IFC and benefited from the assistance of the staff of the International Centre for Settlement of Investment Disputes (ICSID), in particular Antonio R. Parra, Legal Adviser, ICSID. Bertrand P. Marchais, Senior Counsel, MIGA, also contributed to the work of the group.

foreign investors. Although they are based on general trends distilled from detailed surveys of existing legal instruments (published in Volume I of the *Legal Framework for the Treatment of Foreign Investment*), the guidelines are formulated in such a manner as also to incorporate policies that the World Bank Group institutions have been advocating in recent years. This approach, aimed at progressively developing rather than merely codifying applicable rules in the field, has made possible the formulation of progressive standards which are open, fair and consistent both with emerging rules of customary international law and with commendable practices identified by the World Bank Group.

The guidelines and accompanying report were submitted to the Development Committee for consideration at its September 1992 meeting. The Committee reviewed the guidelines with interest and called them to the attention of member countries. In so doing, the Committee noted, in the words of the communiqué of its meeting, that the guidelines should "serve as an important step in the progressive development of international practice in this area."

With the successful completion of this task, it gives me great pleasure to bring its product to the attention of a wider audience through this publication which was envisaged in the communiqué of the Development Committee.

Ibrahim F.I. Shihata
Vice President and General Counsel, World Bank
Secretary-General, ICSID

September 25, 1992

Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investment

Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investment

INTRODUCTORY REMARKS

1. This report is prepared in response to the Development Committee's request, made in its Spring 1991 meeting at the initiative of France, for a report on "an overall legal framework which would embody the essential legal principles so as to promote FDI." It follows a progress report submitted to the Committee in its Spring 1992 meeting which described the approach to be followed and its rationale and outlined the scope of coverage of the proposed framework.

2. The work reflected in this report differs from the task being undertaken since 1977 by the UN Centre on Transnational Corporations (UNCTC) in at least two respects. *First*, this report covers general principles suggested to guide governmental behavior toward foreign investors; it does not include rules of good conduct on the part of the foreign investors. A set of rules for the latter purpose was reflected in negotiated provisions of the UNCTC draft Code of Conduct, which is now being reviewed "in the light of the changed international economic environment."[1] As previously prepared, "[t]hese provisions shared the common goal of maximizing the contributions of [transnational] corporations to the economic and social development of the countries in which they operate and of minimizing their potential negative effects."[2] They specifically relate to disclosure of information by foreign corporations, environmental and consumer protection, restrictive business practices, the avoidance of corrupt practices and transfer pricing, parent-affiliate relations as well as labor relations and working conditions. While the framework covered by this report avoids a repetition of these principles, the guidelines are meant to apply to *bona fide* private investments, where investors act in good faith and in full conformity

---

[1] Report by the President of the Forty-sixth Session of the General Assembly, July 23, 1992.

[2] UNCTC, International Arrangements and Agreements Relating to Transnational Corporations: International Framework for Transnational Corporations—Report of the Secretary-General, U.N. Doc. E/C. 10/1992/8, para. 24 (Feb. 18, 1992) (hereinafter UNCTC Report). In addition, in 1976 the members of OECD adopted Guidelines for Multinational Enterprises which laid down standards for the activities of such enterprises. *See* Annex 1 to Declaration of June 21, 1976 by Governments of OECD Member Countries on International Investment and Multinational Enterprises, in OECD, The OECD Declaration and Decisions on International Investment and Multinational Enterprises: Basic Texts 9 (1992).

with the laws and regulations of the host State.[3] They also provide that restrictions applicable to national investment on account of public order, public health and the protection of the environment will equally apply to foreign investment.[4] Furthermore, the proposed framework includes a recommendation for all States to take appropriate measures for the prevention and control of corrupt business practices and the promotion of accountability and transparency in dealings with foreign investors and to cooperate with other States in developing international procedures and mechanisms to this effect.[5]

3. *Second*, this report does not aim at representing a codification of what are necessarily agreed upon, binding rules of international law. Rather, it attempts to reflect at this stage generally acceptable international standards which meet the objective stated in the Development Committee's request, i.e., the promotion of foreign direct investment. Fortunately, any gap that may exist between principles which are widely accepted as legally binding international law and the guidelines attached to this report is narrowing as a result of the changing realities and perceptions related to the policy environment for foreign investment in practically all developing countries and the intensified normative activity in this field in recent years, at both the regional and global levels. It is recognized, however, that some of the standards prepared here, though not the ultimate that the world community may aspire to, do reflect emerging, rather than settled, standards under contemporary international law and for this reason represent in several respects what is deemed to be desirable, rather than common practice. As they are meant to provide the elements of an *international* framework which may develop in the future into generally accepted standards, the guidelines should not also be read as the ultimate recommended policy for every country interested in attracting foreign investment. The conditions of a specific country may well require it to adopt a more liberal approach, which is justified by its circumstances, than what are deemed to be internationally acceptable standards at this stage.

4. The attempt to formulate generally acceptable international standards to promote the flow of foreign investment is both timely and useful. It is *timely* because of the growing importance of private direct foreign investment in developing countries. Such flows have increased substantially, reaching in 1991 a

---

[3] *See* Section 2 of Guideline I of the guidelines attached to this report. As indicated in the commentary on that section (at *infra* para. 15), this principle is often reflected in existing multilateral instruments on the treatment of foreign investment, such as the Lomé IV Convention and the draft UNCTC Code of Conduct on Transnational Corporations.

[4] Section 5 of Guideline II.

[5] Section 8 of Guideline III.

level almost three times higher than that of 1986[6] and accounting at present for about ten percent of all private investment in the developing countries.[7] They also hold a significant potential for further growth in the 1990s, compared to the expected modest growth in official assistance and commercial lending.[8] This work is also timely because of the great transformation of economies in Eastern Europe, Central Asia and indeed many developing countries, from inward looking economies, based on public sector control and inspired by import substitution policies, into outward looking market economies, based on private sector development and open competition. In conjunction with this transformation, such events as nationalizations of foreign investments are becoming increasingly rare and, with changing patterns of foreign investment flows, traditional classifications of and distinctions between "home" and "host" countries have lost some of their significance, suggesting in turn a more balanced approach to foreign investment issues.[9]

5. This transformation process and the general trend to attract foreign investment make it particularly *useful* to try to devise a general understanding of a desirable normative framework to guide future governmental conduct affecting foreign investment. In this, as in other fields, a sound legal framework, in terms of the availability of clear, stable and reasonable general rules as well as of honest and efficient mechanisms of implementation, enforcement and dispute settlement, is essential. Obviously, such a framework, necessary as it is, cannot be expected alone to cause a major shift in the conditions of investment markets or in investor attitudes towards such markets. Establishing a sound legal and regulatory framework must therefore be seen as one of many basic requirements which together can make a difference in investment decisions and behavior. Providing conditions of political stability, reducing macro-economic imbalances and economic uncertainties, lowering price distortions and improving the functioning of factor markets generally, strengthening financial institutions, improving physical infrastructure and government administration and ensuring the availability of trained, disciplined labor, including white collar and supervisory labor, and of relevant information, along with the presence of successfully operating foreign investors, are other essential requirements which allow an appropriate legal framework to produce the desired results, not only

[6] IBRD Debt and International Finance Division, Financial Flows to Developing Countries: Current Developments, March 1992 at 9.

[7] IFC, Trends in Private Investment in Developing Countries, 1992 Edition at 2 (by Guy P. Pfeffermann and Andrea Madarassy).

[8] *See* IBRD, Global Economic Prospects and the Developing Countries 38–39 and table 3.5 (1991).

[9] UNCTC Report, *supra* note 2, para 7.

for the growth of foreign investment but for private sector development generally.[10] The need for international legal standards is increased by the quest for improved investment climates on a worldwide scale and the uncertainty surrounding international law rules in this field at present. As the latest UNCTC report indicated "[t]he question is no longer whether international norms should exist but whether the international framework as it exists today is sufficient—or, indeed, adequate—to ensure stable, reliable and mutually beneficial foreign investment relations in the new economic and political landscape."[11]

6. While the UNCTC continues its efforts to codify internationally agreed rules to govern the future behavior of foreign investors and their host countries, this report and the guidelines attached to it attempt to identify a set of principles which, it is hoped, are both acceptable in view of recent trends, and likely to enhance the prospects of investment flows to developing countries. Such recommended guidelines may thus guide further work on the subject at the national and international levels. To the extent that the practice of States conforms to these recommended guidelines in a consistent manner and reflects a general conviction of their binding character, the guidelines may then positively influence the development of customary international law in so far as they do not already reflect its rules. While the guidelines could serve these important purposes, they are clearly not intended to constitute part of World Bank loan conditionality or to assume for the Bank a legislative role which it does not have.

7. The remaining parts of this report provide explanatory notes to the guidelines and are meant to facilitate their understanding and help in paving the way for their general acceptability. In reading these guidelines, it is of particular importance to bear in mind the following factors:

i) The guidelines address, and are meant to apply to all member States and indeed to the world community at large; they are not addressed only to developing countries or to a specific coherent regional group of countries.

ii) The guidelines address the conduct of States *vis à vis* foreign investors but not the conduct of foreign investors. The exclusion of

---

[10] *See* Shihata, Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Guarantee Scheme, 21 The International Lawyer 671 (1987); MIGA and Foreign Investment (1988); and Promotion of Foreign Direct Investment—A General Account, with Particular Reference to the Role of the World Bank Group, 6 ICSID Review—Foreign Investment Law Journal 484 (1991). *See also* IFC, *supra* note 7, at 5–6; Mody and Srinavasan, Trends and Determinants of Foreign Direct Investment: An Empirical Analysis of U.S. Investment Abroad (World Bank Working Paper, Dec. 1991).

[11] UNCTC Report, *supra* note 2, para. 34.

the latter topic is not due to its lack of relevance or importance; it only reflects an understanding of the request made by the Development Committee and a desire to avoid repetition of the comprehensive work carried out by UNCTC, and earlier by the OECD, in this field.

iii) The guidelines, being prepared for a practical purpose and not as an academic exercise, are written with a sense of realism, bearing in mind existing legal instruments, complemented by desirable practices consistent with World Bank Group policies.

iv) The guidelines are meant to present a general framework which complements, but cannot substitute for the broad array of international instruments consisting of bilateral investment treaties, regional conventions and other instruments of broader application issued by specialized organizations such as the ILO, GATT, OECD, EC and others, all with the view of securing stable investment conditions in the territories of their members. In this respect, the guidelines, if adopted, would be relevant to situations where such bilateral treaties and other instruments do not exist or are silent on matters provided for in the guidelines. Thus, while the guidelines represent another step in the overall international effort to improve investment conditions and in the continuous evolution of improved standards in this area, they provide a foundation on which other instruments, especially bilateral treaties, may further build.

v) Last, but not least, the guidelines are meant to serve the purpose of promotion and encouragement of foreign investments, so that such investments may increase in volume and spread out to as many countries as possible, and so that their flows may be governed only by economic considerations and not be hampered by avoidable non-commercial factors.

SCOPE OF APPLICATION OF THE GUIDELINES

8. Guideline I of the guidelines delineates their intended scope and purpose. The guidelines may be applied by members of the World Bank Group and other States in their efforts to attract increased flows of private foreign investment. However, the guidelines would not by themselves have a binding or mandatory effect. This is made clear by the contrast that Section 1 of Guideline I draws between the guidelines and such binding instruments as pertinent bilateral and multilateral treaties. The guidelines would be subject to any such treaties and should facilitate the conclusion of more bilateral investment treaties. At the same time, the guidelines may play a useful role in complementing binding instruments in the field of foreign investment. As already indicated, the guidelines incorporate lessons gained from experience of the practices and policies that may be conducive to building an attractive investment climate.

9. A particular practical contribution that the guidelines may make would, as suggested in Section 1 of Guideline I, be to assist in the development of domestic legal rules on foreign investment. For the drafters of national laws on foreign investment, the provisions of the guidelines may, depending on the circumstances, needs and policies of the country concerned, be suggestive of desired provisions in the laws; or the guidelines may simply serve as a checklist of the types of matters that the laws might usefully address. In this context, the guidelines could also help in the coordination of technical assistance to countries in the formulation of investment laws on the basis of a minimum of broadly acceptable standards. More importantly, the guidelines may help in the progressive development of international principles and rules on foreign investment by arbitrators and scholars and may be reflected over time in the practice of States which do not already follow similar standards. The practical value of the guidelines in all these respects is enhanced by the fact that they also present general principles and current trends inferred from extensive comparative background studies of bilateral investment treaties, multilateral treaties and other instruments pertaining to foreign investment, international arbitral awards and writings of international law experts, as well as national investment codes.[12] Thus, the guidelines, while not having a binding character as such, have a basis in existing legal instruments and may not be inconsistent with what some sources may consider to be settled international law. Their adoption is

[12] These studies are reprinted in World Bank Group, Legal Framework for the Treatment of Foreign Investment, Vol. 1. They are the bases for the generalizations in the present report about bilateral investment treaties, multilateral instruments, national investment codes, and international arbitral awards and scholarly writings.

recommended however without prejudice to the different positions held by States and scholars on what international law may or may not require at this stage of its development.

10. The various potential contributions of the guidelines are nevertheless essentially legal in character, as envisaged in the Development Committee's request. Hence the guidelines are in large measure drafted in a normative manner (while using language that is as simple and clear as possible). This would not, of course, itself impart to the guidelines any legal force. As already emphasized, the guidelines are not intended to, nor could they, supersede by themselves such binding instruments as national laws or treaties. Instead, such legal force as the guidelines might eventually acquire would depend on their incorporation by States into domestic or international law in the ways described above.

11. The guidelines are meant to apply to *private foreign* investments. However, the broad general principles set out in the guidelines equally apply to investments made by foreign public entities such as foreign State enterprises or intergovernmental organizations. They also have obvious relevance to investments that are made by local nationals, and in that sense domestic, but with funds brought in from abroad.[13]

12. As they would be intended to assist in the encouragement of private foreign investment generally, the guidelines are purposely broad in scope. Thus while they may in several respects be particularly relevant to private foreign direct investment,[14] there is no reason to limit their application to such investment, to the exclusion of portfolio investment.

13. Indeed beyond specifying that they should be private and foreign, *the guidelines contain no restrictions as to the nature of the covered investments.* In this respect, the guidelines would be similar to most bilateral investment treaties and multilateral instruments which either adopt broad definitions of covered investments or do not qualify them at all.[15] Thus the guidelines would apply to indirect, as well as to direct, investments and to modern contractual and

[13] *Compare* Article 13(c) of the MIGA Convention which opens the possibility of equating local nationals to foreign investors eligible for the Agency's guarantee where the local nationals are investors transferring to the host country assets from abroad.

[14] Paragraph 408 of the IMF Balance of Payments Manual (4th ed. 1977) defines direct investment as "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise."

[15] For example, many bilateral investment treaties define covered investments as including "every kind of asset." Under the MIGA Convention (art. 12), investments eligible for the Agency's guarantee potentially include virtually any "medium- or long-term form of investment." In the ICSID Convention (art. 25(1)), which like the guidelines takes the broadest approach, the term "investment" is purposely undefined.

other new forms of investment where funds, equipment, technology and/or services are provided in a variety of continuously evolving ways, as long as the investor's return depends in whole or in part on the fortunes of the enterprise, as well as to traditional types of foreign investment such as equity contributions and concessions. The guidelines could in general also apply to investments made in local as well as foreign currencies and to investments made in kind as well as in monetary form. They similarly contain no restrictions as to the nature of the covered foreign investors themselves, which may be corporate entities as well as individuals.[16]

14. *State* and *nationals* are other terms frequently used in the guidelines. In foreign investment matters as in other fields, States generally act through their responsible agencies or other public entities. In addition, nationals of a State may include not only individuals who have the nationality of a State but also companies and similar bodies established there. To avoid any misunderstanding, Section 1 of Guideline I specifies that the guidelines are intended generally to cover the stance of a State (or any constituent subdivision or institution acting as the instrumentality or agency thereof) in respect of both individuals and juridical persons possessing the nationality of another State under the law of that State.[17]

15. The guidelines, seeking to set out a general framework for the treatment of foreign investors by their host States, cover each of the main areas in this respect, namely the admission of foreign investment, standards of treatment and transfer of capital and net revenues, expropriation and its compensation and the settlement of disputes. While, as earlier explained, rules regarding the conduct of foreign investors in their host States are not covered, the guidelines only envisage investments made and carried out in good faith and in complete compliance with local legal requirements. This fundamental assumption, which is often articulated in existing multilateral instruments on the treatment of foreign investment, is emphasized in Section 2 of Guideline I and is also reasonably reflected in Section 9 of Guideline IV.

16. Obvious differences distinguish the respective situations of foreign and local investors. Arrangements for the eventual repatriation of investment capital and returns, for example, are typically made with foreign investors only in

---

[16] In potentially accommodating these various forms of investment and investors, the guidelines may be compared to the MIGA Convention (at arts. 12 and 13) and MIGA's Operational Regulations (at paras. 1.01–1.19).

[17] Similarly, under the ICSID Convention (art. 25), States parties may include agencies and subdivisions of States, and nationals of States may include juridical as well as natural persons from States. (Under general international law, a dual national who has the nationalities of the host State and another State or States is considered a national of the host State unless it agrees to treat him differently.)

mind. However, the situations of foreign and local investors may be similar to each other in many more respects. Experience indicates that, *to the extent the circumstances of foreign and local investors are thus essentially similar,* their equal treatment and hence competition on an equal footing, are important factors in creating a sound investment climate. The practice of granting foreign investors special privileges unwarranted by their particular circumstances may distort trade and competition and, in the final analysis, contribute little to the attraction of foreign investment. As is underscored by Section 3 of Guideline I, the guidelines are not intended to endorse the extension of such special privileges to foreign investors. This does not however derogate from the fact that in some respects the nature of the investment or of the investor as foreign may justify a different treatment as indicated above.

ADMISSION

17. Guideline II covers the question of the admission or entry of foreign investments into host countries. Like corresponding introductory provisions of most bilateral investment treaties and many multilateral instruments and national investment codes, Section 1 of Guideline II makes explicit the need for host countries to encourage foreign investment. In so doing, the Section calls attention to the fact that the encouragement of foreign investment may usefully be directed not only to contributions of capital but also to the transfers of the technology, knowledge and skills that frequently accompany foreign direct investment and add to its value for the efficiency and competitiveness of the host country.[18]

18. Section 2 of Guideline II gives practical expression to the general principle set forth in Section 1. In common with the provisions of many bilateral and multilateral investment treaties and national investment codes, Section 2 envisages that host countries will facilitate the admission and establishment of foreign investments. Particular reference is made in this connection to the need to avoid overregulation of and the erection of unnecessary bureaucratic obstacles to admission. In this respect, the guidelines may be compared to many modern national investment codes which seek to do away in principle with admission procedures and, where such procedures are necessary, to streamline them through such devices as "one-stop shops" for investment approvals.[19]

---

[18] *See* Shihata, Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Guarantee Scheme, *supra* note 10.

[19] *See, e.g.*, Mahmassani, The Legal Framework for Investment in Poland, 3 ICSID Review—Foreign Investment Law Journal 286, 297 (1988).

19. Some regulations on admission exist however in all legal systems. Section 3 of Guideline II makes it clear that States maintain the right to make such regulations. In this respect, the guidelines are consistent with most bilateral and multilateral investment treaties which also recognize that the admission of foreign investment is ultimately a matter for each State to decide upon and regulate in the exercise of its sovereignty.[20]

20. However, Section 3 of Guideline II cautions against a restrictive approach and in particular against the inclusion in such regulations of certain performance requirements (such as minimum local ownership and staffing or export targets) as conditions of admission of foreign investment. As the Section explains, experience indicates that the imposition of such requirements may deter investments or encourage abuses. Reflecting this experience, performance requirements of these kinds are in fact becoming rare in national investment codes. Such codes increasingly take the approach of making admission a largely automatic process, confining exclusions or approval requirements to specified types of investment judged in need of such control.[21] Section 3 of Guideline II endorses this approach, while pointing out that the fact that a given investment requires no specific approval does not, of course, exempt it from the host State's laws and regulations which typically require registration and expect full compliance.

21. Sections 4 and 5 of Guideline II mention especially important types of exclusions that States may legitimately make under the liberal approach endorsed by Section 3. Thus States may open admission to investments without the need for prior approval but exclude from their territories foreign investments which threaten national security under clearly defined requirements or which belong to sectors reserved by the law of the State to its nationals on account of the State's economic development objectives or national interest requirements. Beyond this, there may be other exclusions of investments that would apply equally to national and foreign investments. Such exclusions would relate to investments which are contrary to *ordre public* (sometimes translated into English as "public policy"), i.e. investments that violate fundamental values of society in the country concerned as defined in its laws and judicial practice, and investments that adversely affect the environment or public health. It is important to note, however, that exclusions of foreign investment are not meant to be applied lightly by the host State, but rather as

[20] In their investment laws also, States uniformly reserve to themselves the ultimate decision on the admission of foreign investments.

[21] *See, e.g.*, Pogany, Recent Developments Relating to Foreign Investment in Hungary, 6 ICSID Review—Foreign Investment Law Journal 114 (1991).

limited exceptions after careful consideration. This point is recalled in Section 4 of Guideline II.

22. Investment codes also frequently reserve to nationals investments in sectors where it is considered that national interests demand such local control of the sectors concerned. As in some of the more recent codes, however, this latter type of restriction should be limited to sectors which are normally by nature of primarily local interest in any event. Section 4 of Guideline II recognizes that such limited restrictions may be inevitable; it does not suggest them as a rule but as an exception.

23. Assessments of local investment conditions invariably precede the decision of a serious investor actually to make an investment in a country. In order to attract foreign investments, States may find it useful actively to facilitate such assessments by prospective investors. Of special importance in this connection is the identification of relevant current local legal requirements and policies. Language and cultural differences can make this a particularly onerous undertaking for foreign investors. Their task in this respect may be partially eased by consolidating in one publication the main rules that will apply to foreign investors. Such an investment handbook may summarize the applicable rules, refer to all relevant laws and regulations and provide other information that intending investors typically require, whether or not they are reflected in an investment code.[22] Apart from the great interest of foreign investors in such a publication, it may provide a good occasion for host States also to assess the appropriateness of their foreign investment regimes. Some host States follow the approach of making available such handbooks or other summaries and Section 6 of Guideline II commends the practice.

TREATMENT

24. Guideline III covers both the general standards of the treatment to be accorded to foreign investors by their host States and particular aspects of such treatment, notably the transfer of investment capital and returns.

25. A standard of treatment is by definition a general criterion. It clearly could lose much of its value if it only applied to parts of the activities of foreign investors. In fact, bilateral investment treaties and multilateral instruments that lay down general standards of treatment appear never to restrict the scope of the standard in this way. Accordingly, Section 1 of Guideline III makes it clear that the level of treatment recommended would cover not only the establishment

[22] *Compare* Wälde, Investment Policies and Investment Promotion in the Mineral Industries, 6 ICSID Review—Foreign Investment Law Journal 94, 112 (1991).

of an investment but also the various aspects of its operation and the activities reasonably ancillary to it including the ultimate disposal of the investment.[23] In so doing, the Section recalls that the guidelines are meant to apply simultaneously to all States. It also emphasizes that the detailed standards provided for in the guidelines are subject to applicable bilateral treaties, multilateral conventions and other binding international instruments as well as to generally accepted rules of customary international law.

26. Most bilateral investment treaties and several multilateral instruments in the field prescribe an objective standard of "fair and equitable" treatment to be accorded to foreign investors. Section 2 of Guideline III follows this example and relates the standard to the guidelines as a whole.

27. Most bilateral investment treaties also require that foreign investors be accorded treatment that, in addition to being fair and equitable, is as favorable as that accorded by States to their own nationals. Many multilateral instruments and national investment codes similarly provide for a supplementary standard of national treatment. One important aspect of this standard is that foreign investors should not lack the protection and security afforded to nationals, for example with respect to the safeguarding of their persons or property interests. Another important implication of the standard is that foreign investors should not, in comparison with nationals, be put at a competitive disadvantage in respect of access to the permits or authorizations necessary to conduct business operations in the country concerned. These factors are all taken into account in Section 3(a) of Guideline III, which elaborates on the principle of "protection and security" and recommends that, in the application of this principle, foreign investors be granted treatment as favorable as that granted to nationals, provided, of course, that investors' interests and rights over their property, including intellectual property, are thereby fully protected in all its aspects of ownership, control and benefits and, more generally, that the treatment is also fair and equitable.

28. Section 3(a) of Guideline III recalls that foreigners may receive national treatment to the extent that the circumstances of the two groups are similar. As indicated earlier, obvious differences between the situations of foreigners and nationals may call for them to be treated differently in certain areas. Section 3(b) of Guideline III recommends that, where this is the case, the host State's rules should not discriminate among different foreign investors on the grounds of their respective nationalities. In this respect, the guidelines are similar to

[23] It can in this connection be noted that the scope of some bilateral investment treaties is explicitly extended to cover activities associated with investments as well as investments themselves.

several multilateral instruments on investment formulated in both industrial and developing country fora and provide for the equivalent of a "most favored nation clause" which is the formula typically used in the context of bilateral treaties.

29. At the same time, many bilateral investment treaties in particular allow for the drawing of distinctions in the treatment of foreign investors on the basis of membership in such treaty arrangements as customs unions and free trade areas. Section 4 of Guideline III acknowledges this common exception which, in the present context, can be viewed as another application of the principle that the guidelines are subject to applicable treaties. Consistent with the approach taken under the General Agreement on Tariffs and Trade (GATT), however, investors from third countries should not as a result be accorded less favorable treatment than that which they enjoyed prior to the formation of the customs union or comparable arrangement.

30. In addition to the general standards of treatment, the guidelines provide several concrete illustrations of treatment conducive to attracting foreign investment. These include the timely issuance of such authorizations as may be required for the smooth operation of investments. In this respect, the guidelines reflect the spirit of modern national investment codes the provisions of which typically seek to facilitate and expedite such authorizations.[24] Such codes sometimes still require foreign investors to recruit a minimum number of their personnel locally. However, this approach is increasingly being abandoned in favor of one emphasizing market freedom in hiring. While mentioning the normal practice of following certain procedures to establish the need for foreign personnel, Section 5(b) of Guideline III recommends a flexible approach as one more suited to stimulate foreign investment. It recognizes the importance of labor market flexibility in this and other areas, and emphasizes in particular the investor's freedom to fill top management positions regardless of nationality. Such flexibility will normally result in largely local hiring in any case because of the relatively higher cost of foreign personnel.

31. The transfer of funds abroad is another fundamental aspect of the treatment of foreign investment. Such funds include the salaries and savings of expatriate personnel, investment profits, amounts needed to service debts and other contractual obligations of the investment enterprise, as well as investment liquidation or sale proceeds. Minimization of restrictions on the transfer of such funds is a hallmark of existing instruments that is reflected in the guidelines. Thus many bilateral investment treaties envisage that foreign investors should be free to repatriate their net profits; like several multilateral instruments,

[24] *See* text accompanying *supra* note 19.

Section 6(1) of Guideline III provides for the same freedom. Obviously, this freedom may be subject to exceptions provided for in binding international instruments such as the Articles of Agreement of the International Monetary Fund (IMF) (which prevail over these guidelines).[25] As in the case of several bilateral investment treaties and over a dozen national investment codes, comparable freedom of transfer is envisaged by Section 6(1) for salary and savings remittances of foreign personnel and for debt service and other contractual payments. Bilateral and multilateral investment instruments and national investment codes typically provide for similar freedom of transfer in respect of investment liquidation proceeds. In view of the large sums that such proceeds may involve, some bilateral investment treaties and national investment codes refer to the exception of effecting transfer of liquidation proceeds over limited periods (of up to five years) where this is dictated by the balance of payments positions of the countries concerned. Section 6(1) of Guideline III likewise refers to this exception only in the context of the repatriation of investment liquidation or sale proceeds, as a derogation from the rule of free transfer when necessitated by the lack of adequate foreign exchange in the central bank (or similar agency) at the time the request for transfer is made and, in all cases, subject to the payment of interest. Finally, Section 6(1) of the Guideline also refers to freedom of transfer of other amounts such as those to which an investor may be entitled as compensation for expropriation or under a judicial or arbitral decision.

32. Bilateral investment treaties and several multilateral instruments contain provisions designed to assure that amounts may be transferred in currencies usable to the investor. In this connection, Section 6(2) of Guideline III, in a manner similar to bilateral investment treaties, refers to currencies imported by the investors concerned (if the currencies remain convertible), currencies designated by the IMF as freely usable, or currencies accepted by the investors. Obviously, only the latter two methods will apply to investments which do not take the form of monetary contributions. Bilateral investment treaties also specify that transfers will be made at prevailing exchange rates. In this connection, some bilateral investment treaties refer to official rates of exchange, others to exchange rates determined in accordance with IMF regulations, and some to the market rate of exchange. In the context of foreign investments, the market rate may in general be likely to be a particularly reliable measure of the

[25] The latter exceptions include exchange restrictions in effect when a country became a member of the IMF and maintained as transitional arrangements and restrictions approved by the IMF. For details, see Silard, Exchange Controls and External Indebtedness; Are the Bretton Woods Concepts Still Workable?—A Perspective from the International Monetary Fund, 7 Houston Journal of International Law 53 (1984).

actual value of the local currency concerned. Accordingly, Section 6(2) of Guideline III, in recommending that transfers be authorized at exchange rates prevailing on the date of the transfer, refers to the market rate of exchange applicable to the transaction concerned.

33. Section 6(3) of Guideline III also recommends the payment of interest on the local currency received by the banking authorities of the host State in respect of any delays in effecting the required transfers. Such interest would, in particular, compensate the investor for delays in the transfer of the local currency amount representing liquidation proceeds in the exceptional cases when, as foreseen by Section 6(1)(d) of Guideline III, such transfer may be made by installments. Comparable provisions on interest for transfer delays may be found in some but not all bilateral investment treaties.

34. Under the applicable law, which will normally be the law of the host State, the investor might be entitled to compensation for loss due to events of international or civil strife, such as war or revolution. Section 6(4) of Guideline III recommends that the Guideline's provisions on transfer of capital should also apply to the transfer of any such compensation to which the investor may thus be entitled. In this respect, the guidelines may be compared to provisions of many bilateral investment treaties calling for such compensation to be freely transferable.

35. If the investor so chooses, it is clearly normally in the best interests of the host State that investment returns and liquidation proceeds be reinvested there rather than repatriated.[26] Section 7 of Guideline III accordingly recommends that host States permit and facilitate such reinvestment. This does not in any way imply that the State should create obstacles to free transfer.

36. After the provision of Section 8 of Guideline III on the need to prevent and control corrupt business practices (referred to in paragraph 2 above), Section 9 of this Guideline presents recommendations of "best practice" with respect to the further area of tax exemptions and other fiscal incentives. The Section cautions against the granting by host States of such exemptions and incentives, a practice which is increasingly motivated by competition among host States. It will be recalled that these exemptions or incentives often represent unjustified sacrifices on the part of host States or serve as poor substitutes for appropriate overall policies affecting investments. Foreign investors may in fact be discouraged by the instability or unpredictability of a regime that incorporates tax holidays and the like followed by significant increases in tax rates to offset the initially foregone revenues of the host State. As Section 9 of

---

[26] Reinvestment of investment amounts is encouraged by, inter alia, the MIGA Convention (art. 12(c)(ii)) to avoid negative effects on the balance of payments of the host country.

Guideline III explains, reasonable and stable tax rates provide better incentives to investors. Where the host State decides that fiscal exemptions are nevertheless justified, Section 9 of Guideline III recommends that, in keeping with other parts of the guidelines, they be made available, for the types of activity to be encouraged, to foreign and national investors equally and with a minimum of bureaucratic discretion in the matter. On the other hand, Section 10 of Guideline III mentions a number of measures[27] which some investors' countries take to assist investment flows to developing countries; in this respect, the Section recognizes the granting of fiscal incentives to investors by their home States as a possibly effective means of encouraging such flows.

EXPROPRIATION AND UNILATERAL ALTERATIONS OR TERMINATION OF CONTRACTS

37. Guideline IV covers the subject of expropriation of foreign investments. The Guideline also addresses the question of unilateral changes by host governments of contracts with foreign investors for non-commercial reasons, a subject which is often associated with and made subject to several of the same principles as those governing expropriation. These have been controversial subjects. The background studies on which the guidelines are partly based show that there is however significant consensus on most of the issues involved. Building on this consensus and best practice, the guidelines offer practical solutions to such issues and avoid the ideological approaches that have led to much of the controversy in the past.

38. Many national investment codes, virtually all bilateral investment treaties and most pertinent multilateral instruments contain provisions to the effect that host States may expropriate foreign investments only if the takings are done in accordance with applicable legal procedures, for a public purpose and against payment of compensation. These provisions are typically broad enough to encompass partial as well as total expropriations of foreign investments. The provisions in the bilateral investment treaties and multilateral instruments also often explicitly cover not only outright expropriations but also measures, such as excessive and repetitive tax or regulatory measures, that have a *de facto* confiscatory effect in that their combined effect results in depriving the investor in fact from his ownership, control or substantial benefits over his enterprise, even when each such measure taken separately does not have this effect (so-called

[27] *See also* the paper on Resource Flows to Developing Countries prepared by World Bank and IMF staff for submission to the Development Committee in September 1992.

"creeping expropriations").[28] A further element that frequently appears in the bilateral investment treaties and multilateral instruments is that takings by the host State of foreign investments should not discriminate among investors on the basis of their nationalities. All of these elements are also supported by international arbitral awards and scholarly writings on the subject. Each element is incorporated into the definition of permissible expropriations in Section 1 of Guideline IV which, for the sake of clarity, adds that the required pursuit of a public purpose be in good faith.[29]

39. The point of significant disagreement over the conditions of permissible expropriations has concerned the measure of compensation for such expropriations. Most bilateral investment treaties and many western writers have adopted the well-known formula calling for "prompt, adequate and effective" compensation. Many national laws (of both industrial and developing countries) and most multilateral instruments employ more general terms to describe the required compensation, such as "just" or "appropriate." The two approaches are not, of course, mutually exclusive—for example, compensation that is prompt, adequate and effective may also be the most appropriate. As pertinent international arbitral awards indicate, much depends in this area on the circumstances of the case at hand. With this in mind, the guidelines take a practical approach to the matter, employing first the all-embracing term—appropriate—for the recommended general standard on compensation in Section 1 of Guideline IV, and then specifically applying this in Section 2 to indicate, in the context of the taking of a specific investment by a State, that compensation will normally be deemed to be appropriate if it is "adequate, effective and prompt." Sections 3–6 of Guideline IV elaborate upon this recommendation by providing important practical details suggested by judicial and arbitral experience. Of particular value in this connection are the findings of international arbitral awards which provide details on the often vague general standards embodied in treaties, other international instruments and national legislation.

40. Thus in line with many such awards—as well as significant numbers of bilateral investment treaties and multilateral instruments and some national investment codes—Section 3 of Guideline IV explains that the level of compensation for such a taking will be deemed to be "adequate" if it is based on the fair market value of the taken asset immediately before the taking occurred or the State's decision to take the asset became publicly known. Section 4 of the Guideline encourages agreements between States and foreign

---

[28] *See, e.g.*, Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Review—Foreign Investment Law Journal 41 (1986).

[29] A similar precision regarding good faith is included in a provision (para. 1.36) of MIGA's Operational Regulations on the expropriation risk.

investors on how this value should be determined. Where the parties fail to reach such agreement, Section 5 of Guideline IV, again following international arbitral precedent, recommends that the fair market value may be assessed by determining the price that a willing buyer would normally pay to a willing seller of the investment, after taking into account all relevant circumstances such as the nature and duration of the investment. Throughout, reasonable criteria would be applied with a view to ascertaining the market value of the investment.

41. While the guidelines would not and could hardly seek to impose rigid criteria or hard and fast rules in this respect, Section 6 of Guideline IV presents, on the basis of experience in international arbitrations in particular, different methods of valuation for different types of assets as examples of appropriate ways of determining the market worth of an investment.[30]

42. For a *going concern*, i.e. an enterprise consisting of income-producing assets and already in existence for a sufficient period of time to generate the data necessary for proving its profitability and the calculation, with reasonable certainty, of its income in future years (on the assumption that the taking did not occur), Section 6 of Guideline IV suggests that *discounted cash flow* may represent an acceptable method of valuation. This method values an income-producing asset by estimating the *net* cash flow which the asset could be realistically expected to generate over the course of its life, and then discounting that net cash flow by a factor that reflects the time value of money, expected inflation and the risk associated with the cash flow. This method is regarded as appropriate for valuing enterprises with a firmly established income-producing capacity because it recognizes that the economic value of such an enterprise to its owner is a function of the cash that the enterprise can be expected to produce in future. However, particular caution should be observed in applying this method as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits.[31] Compensation under this method is not appropriate for speculative or indeterminate damage,[32] or for alleged profits

---

[30] On the experience in international arbitrations in this respect, see in particular Friedland and Wong, Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies, 6 ICSID Review-Foreign Investment Law Journal 400 (1991).

[31] *See* fourth study in Legal Framework for the Treatment of Foreign Investment, Vol. I, *supra* note 12, at 146. *See also* Westberg, International Transactions and Claims Involving Government Parties—Case Law of the Iran-U.S. Claims Tribunals 252 (1991); Amerasinghe, Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice, 4 International and Comparative Law Quarterly 22 (1992).

[32] *See* Chorzow Factory Case, PCIJ Ser. A, No. 17, 1928, at 51; Amoco International Finance Corporation v. Iran, 15 Iran-U.S. C.T.R., at 238.

which cannot legitimately accrue under the laws and regulations of the host country.[33]

43. For *an enterprise lacking profitability*, Section 6 of Guideline IV provides as an example of an appropriate valuation method one which looks to the assets' *liquidation value*. This method values an enterprise with demonstrated lack of profitability as the sum of the amounts at which the individual assets comprising the enterprise could be sold less any liabilities that the enterprise might have to meet.

44. For *other assets*, recourse may be had to the *replacement value method*. This method measures value on the basis of the amount of cash that would have been required to purchase the individual assets that have been expropriated at their actual state as of the date of the taking. This method obviously assumes that the assets in question are replaceable, which may not always be the case. In addition, the replacement value may not always reflect the value that individual assets may have had together in an enterprise. This problem may be addressed by using the *book value method*. Book value means the difference between a company's assets and liabilities as recorded in its financial statements, or the amount at which the expropriated asset appears on the enterprise's balance sheet after deducting accumulated depreciation in accordance with generally accepted accounting principles. In the guidelines, this method of valuation is only recommended for cases where such book value has been recently assessed and can therefore be deemed to be a fair substitute for the replacement value. In any case, the "book value" cannot present a fair methodology if it bears no relationship to the market value.

45. Sections 7 and 8 of Guideline IV consider the two other elements of the general recommendation on appropriate compensation for takings of specific investments, namely the effectiveness and timeliness of such compensation. In both respects, the Sections logically recall the guidelines' recommendations on transfer of capital. It is in this context worth noting that some national investment codes and several bilateral investment treaties explicitly link their provisions on compensation for expropriation with those on transfer. In a manner similar to the transfer provision of Section 6(2) of Guideline III, Section 7 of Guideline IV thus deems compensation to be effective if it is paid in the currency originally imported by the investor (if it remains convertible at the time of transfer), in another currency designated as freely usable by the IMF or in any other currency accepted by the investor, with only the latter two methods applying to investments which do not take the form of monetary contributions.

[33] *See* de Laubadère, 2 Traité des Contrats Administratifs 556 and 1327 (1984). The same principle has been reflected in a recent ICSID award.

46. As indicated earlier, many bilateral investment treaties require that compensation for expropriation be paid promptly or without delay. Of course, such treaties are only binding on the States parties to them. Countries not parties to such treaties do not always accept that prompt payment is legally required. Significant numbers of other bilateral treaties and multilateral instruments recognize that there may be reasonable delays in effecting compensation. They accordingly rule out only undue delays in payment. Elaborating on this, several treaties acknowledge that host countries may face foreign exchange stringencies and therefore allow payment of compensation by installments, subject to the payment of proper interest in respect of the deferred payments. Such circumstances and possibilities are acknowledged within narrow time limits by Section 8 of Guideline IV only as exceptions from the general rule of prompt payment in the cases justifying them. The Section refers in this context to cases where there are arrangements for the use of IMF resources or similar objective circumstances of established foreign exchange stringencies. This elaboration is well justified as Section 8 of Guideline IV, in dealing with compensation for an expropriation, addresses consequences of a deliberate decision by the State.[34] Under both Guidelines III and IV, however, the exceptions should be read as a realistic recognition of inevitable compelling circumstances, not as a permit to avoid transfers where these are possible.

47. The above general principles, which envisage ordinary takings of specific investments, may not be fully applicable in respect of certain other types of takings. For example, a foreign investor may be entitled to lesser compensation or to none at all in respect of an expropriation that results from a breach by the investor of the laws of the host State, as may occur when the investment is used as a conduit for drug trafficking or for other criminal activity, or involves gross violations of anti-trust or environmental laws. This point is made in Section 9 of Guideline IV which of course only envisages cases of sanctions properly imposed by courts of law and assumes a proper application of the principle of proportionality (under which a minor offense, for example, should not provide a basis for such a drastic response as a taking). In this context, the Section raises the possibility of any further claims by the investor for compensation being referred to the mechanisms of settlement of disputes mentioned in Guideline V.

48. Also clearly to be distinguished from takings of specific investments are comprehensive non-discriminatory nationalizations of the kinds that take place in the context of large scale social reforms following the most exceptional circumstances of revolutionary changes, war, and similar exigencies. Many international law writers acknowledge that in such contexts States may be required

[34] *Compare supra* paras. 31 and 33.

to pay only partial compensation.[35] Expropriations of these kinds may typically have important international as well as domestic policy dimensions. In view of this, compensation arrangements in such unusual circumstances have in practice often been negotiated between the home and host States of the investors, resulting as a practical matter in partial compensation.[36] Without necessarily suggesting any particular outcome in these circumstances, Section 10 of Guideline IV notes that compensation for such expropriations may more appropriately be determined through negotiations between the States involved or, failing such negotiations, by their submission of the matter to international arbitration. This provision addresses circumstances which rarely occur and which may be expected to become more uncommon in future.

49. Under the laws of most countries, State parties to commercial contracts with foreign nationals are generally bound by such contracts to the same extent as non-State parties would be. However, under many legal systems a State may in the exercise of its sovereign powers, that is, when it acts as a sovereign, not simply as a contracting party, unilaterally change, terminate or repudiate the contract. This practice is tolerated in the practice of States when done in the *bona fide* pursuit of a public purpose, rather than for commercial reasons, and against just compensation. Section 11 of Guideline IV recommends that such practice be subject to the same conditions as expropriation and that in such cases foreign investors should be compensated according to principles similar to those set out in the guidelines for expropriation of specific investments. In this respect, the guidelines reflect the findings of several international arbitral awards and international law writers.

---

[35] *See, e.g.*, American Law Institute, Restatement (Third) of Foreign Relations Law 712 cmt. (1987) (suggesting that "[i]n exceptional circumstances, some deviation from the standard of [full] compensation" might be justified, and mentioning in this context takings of alien property "during war or similar exigency"); 1 Oppenheim, International Law 352 (8th ed. Lauterpacht 1955) (suggesting that, "in cases in which fundamental changes in the political system and economic structure of the State or far-reaching social reforms entail interference, on a large scale, with private property..., [i]t is probable that, consistently with legal principle, [the] solution must be sought in the granting of partial compensation"). *See also* other writers cited in Legal Framework for the Treatment of Foreign Investment, Vol. I, *supra* note 12, at 142.

[36] *See, e.g.*, Lillich, Lump Sum Agreements, 8 Encyclopedia of Public International Law 367 (1985) (referring to "the nearly 200 lump sum agreements" that home and host States have negotiated since the Second World War, under which host States have, in settlement of claims occasioned by war, nationalization programs, revolutions, etc., paid fixed amounts to home States for distribution among claimants).

SETTLEMENT OF DISPUTES

50. Particularly in the context of arrangements with States, disputes are normally resolved through negotiations and relatively rarely by recourse to contentious procedures. Section 1 of Guideline V further encourages the negotiated resolution of conflicts between foreign investors and their host States. In case negotiations fail, the courts of the host State will normally and unless otherwise provided have jurisdiction over disputes arising out of investments made in the country. In most countries, it is however possible for States and foreign investors to refer their differences to such alternative mechanisms as conciliation or binding arbitration. Recourse to such mechanisms is dependent on agreement between the parties to make use of the mechanism for the dispute in question. In the field of foreign investment, parties frequently do agree to refer their disputes to arbitration in particular. This practice is endorsed by Section 1 of Guideline V.

51. One of the advantages of arbitration is that it offers parties great scope to structure as they see fit their dispute settlement procedures. Their decisions on such procedures will be embodied in their agreement to have recourse to arbitration. In this context, States in particular may, as a condition of their agreement to refer disputes with foreign investors to arbitration, require the investor to resort to local administrative or judicial remedies before initiating such arbitration. This possibility is recognized by such instruments as the Convention establishing the International Centre for Settlement of Investment Disputes (ICSID) and several bilateral investment treaties. It is not however mentioned in the guidelines as it is rarely pursued in practice.

52. The arbitration that Guideline V envisages as a possible alternative to adjudication before national courts is impartial or independent arbitration. It is widely acknowledged that in the field of international investment arbitration in particular arbitrators should be, and be seen to be, impartial and independent.[37] At the same time, arbitrators are generally chosen through appointments by the parties to the dispute in question. One of the perceived advantages of arbitration is in fact the opportunity that it thus gives parties to have their dispute decided by judges of their own choosing. In appointing arbitrators, each party may naturally wish to select persons who may be expected to be sympathetic to the point of view of the appointing party. To ensure the necessary impartiality of the tribunal as a whole, arbitral tribunals thus commonly consist of one arbitrator appointed by each side and a presiding arbitrator appointed by agreement of the parties or by a neutral appointing authority designated by the parties. An alternative that avoids the costs to the parties of a three-arbitrator panel is to submit the dispute to a sole

[37] *See, e.g.*, Redfern and Hunter, Law and Practice of International Commercial Arbitration 213–25 (2d. ed. 1991).

arbitrator appointed by both parties or by a third party entrusted by them with the role of making such an appointment. Where however the appointment of a sole arbitrator or of a majority of arbitrators is made by one party only, the independence of the tribunal could easily be put in doubt. Section 2 of Guideline V emphasizes the importance of avoiding such a procedure and excludes a tribunal so constituted from the definition of independent arbitration.

53. The independence and impartiality of arbitrators receive particular emphasis in the rules of ICSID, the international conciliation and arbitration forum sponsored by the World Bank and specially designed to handle disputes between States and foreign investors.[38] Provisions for the resolution of such disputes in bilateral investment treaties, national investment codes and individual investment agreements frequently refer to the arbitration procedures of ICSID. The widespread acceptability of ICSID procedures, indicated by the large number of countries (120) that have so far signed the ICSID Convention, and by the reference to ICSID arbitration in hundreds of large investment contracts, may be due, in addition to its relatively low cost, to the fact that it is the only form of arbitration where awards are not subject to subsequent judicial review in ICSID member countries. ICSID in fact provides two kinds of independent arbitration procedures: ICSID Convention arbitration procedures, which are available for cases where both the home and the host State of the investor are parties to the ICSID Convention; and arbitration procedures under the so-called ICSID Additional Facility, which are available for cases where either the home or the host State is not a party to the Convention. References to both types of procedures are frequently included in the provisions referred to above of bilateral investment treaties and national investment codes. Section 3 of Guideline V further encourages such use, as appropriate, of procedures provided by the ICSID Convention or Additional Facility.

---

[38] *See* ICSID Convention at arts. 14(1) and 40(2); Shihata, The Experience of ICSID in the Selection of Arbitrators, 6 News from ICSID, No. 1, at 4 (1989). For general descriptions of ICSID and ICSID arbitration, see, e.g., Broches, Arbitration Under the ICSID Convention (ICSID publication, 1991); Shihata, Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA (ICSID publication, 1992); and Paulsson, ICSID's Achievements and Prospects, 6 ICSID Review-Foreign Investment Law Journal 380 (1991).

Guidelines on the Treatment of Foreign Direct Investment

Guidelines on the Treatment of Foreign Direct Investment

The Development Committee

Recognizing

that a greater flow of foreign direct investment brings substantial benefits to bear on the world economy and on the economies of developing countries in particular, in terms of improving the long term efficiency of the host country through greater competition, transfer of capital, technology and managerial skills and enhancement of market access and in terms of the expansion of international trade;

that the promotion of private foreign investment is a common purpose of the International Bank for Reconstruction and Development, the International Finance Corporation and the Multilateral Investment Guarantee Agency;

that these institutions have pursued this common objective through their operations, advisory services and research;

that at the request of the Development Committee, a working group established by the President of these institutions and consisting of their respective General Counsel has, after reviewing existing legal instruments and literature, as well as best available practice identified by these institutions, prepared a set of guidelines representing a desirable overall framework which embodies essential principles meant to promote foreign direct investment in the common interest of all members;

that these guidelines, which have benefitted from a process of broad consultation inside and outside these institutions, constitute a further step in the evolutionary process where several international efforts aim to establish a favorable investment environment free from non-commercial risks in all countries, and thereby foster the confidence of international investors; and that these guidelines are not ultimate standards but an important step in the evolution of generally acceptable international standards which complement, but do not substitute for, bilateral investment treaties,

therefore *calls the attention* of member countries to the following Guidelines as useful parameters in the admission and treatment of private foreign investment in their territories, without prejudice to the binding rules of international law at this stage of its development.

I
SCOPE OF APPLICATION

1. These Guidelines may be applied by members of the World Bank Group institutions to private foreign investment in their respective territories, as a complement to applicable bilateral and multilateral treaties and other international instruments, to the extent that these Guidelines do not conflict with such treaties and binding instruments, and as a possible source on which national legislation governing the treatment of private foreign investment may draw. Reference to the "State" in these Guidelines, unless the context otherwise indicates, includes the State or any constituent subdivision, agency or instrumentality of the State and reference to "nationals" includes natural and juridical persons who enjoy the nationality of the State.

2. The application of these Guidelines extends to existing and new investments established and operating at all times as *bona fide* private foreign investments, in full conformity with the laws and regulations of the host State.

3. These Guidelines are based on the general premise that equal treatment of investors in similar circumstances and free competition among them are prerequisites of a positive investment environment. Nothing in these Guidelines therefore suggests that foreign investors should receive a privileged treatment denied to national investors in similar circumstances.

II
ADMISSION

1. Each State will encourage nationals of other States to invest capital, technology and managerial skill in its territory and, to that end, is expected to admit such investments in accordance with the following provisions.

2. In furtherance of the foregoing principle, each State will:

(a) facilitate the admission and establishment of investments by nationals of other States, and

(b) avoid making unduly cumbersome or complicated procedural regulations for, or imposing unnecessary conditions on, the admission of such investments.

3. Each State maintains the right to make regulations to govern the admission of private foreign investments. In the formulation and application of such regulations, States will note that experience suggests that certain performance requirements introduced as conditions of admission are often counterproductive and that open admission, possibly subject to a restricted list of investments (which are either prohibited or require screening and licensing), is a more effective approach. Such performance requirements often discourage foreign investors from initiating investment in the State concerned or encourage evasion and corruption. Under the restricted list approach, investments in non-listed activities, which proceed without approval, remain subject to the laws and regulations applicable to investments in the State concerned.

4. Without prejudice to the general approach of free admission recommended in Section 3 above, a State may, as an exception, refuse admission to a proposed investment:

(i) which is, in the considered opinion of the State, inconsistent with clearly defined requirements of national security; or

(ii) which belongs to sectors reserved by the law of the State to its nationals on account of the State's economic development objectives or the strict exigencies of its national interest.

5. Restrictions applicable to national investment on account of public policy (*ordre public*), public health and the protection of the environment will equally apply to foreign investment.

6. Each State is encouraged to publish, in the form of a handbook or other medium easily accessible to other States and their investors, adequate and regularly updated information about its legislation, regulations and procedures relevant to foreign investment and other information relating to its investment policies including, *inter alia*, an indication of any classes of investment which it regards as falling under Sections 4 and 5 of this Guideline.

III
TREATMENT

1. For the promotion of international economic cooperation through the medium of private foreign investment, the establishment, operation, management, control, and exercise of rights in such an investment, as well as such other associated activities necessary therefor or incidental thereto, will be consistent with the following standards which are meant to apply simultaneously to all States without prejudice to the provisions of applicable international instruments, and to firmly established rules of customary international law.

2. Each State will extend to investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended in these Guidelines.

3. (a) With respect to the protection and security of their person, property rights and interests, and to the granting of permits, import and export licenses and the authorization to employ, and the issuance of the necessary entry and stay visas to their foreign personnel, and other legal matters relevant to the treatment of foreign investors as described in Section 1 above, such treatment will, subject to the requirement of fair and equitable treatment mentioned above, be as favorable as that accorded by the State to national investors in similar circumstances. In all cases, full protection and security will be accorded to the investor's rights regarding ownership, control and substantial benefits over his property, including intellectual property.

(b) As concerns such other matters as are not relevant to national investors, treatment under the State's legislation and regulations will not discriminate among foreign investors on grounds of nationality.

4. Nothing in this Guideline will automatically entitle nationals of other States to the more favorable standards of treatment accorded to

the nationals of certain States under any customs union or free trade area agreement.

5. Without restricting the generality of the foregoing, each State will:

(a) promptly issue such licenses and permits and grant such concessions as may be necessary for the uninterrupted operation of the admitted investment; and

(b) to the extent necessary for the efficient operation of the investment, authorize the employment of foreign personnel. While a State may require the foreign investor to reasonably establish his inability to recruit the required personnel locally, e.g., through local advertisement, before he resorts to the recruitment of foreign personnel, labor market flexibility in this and other areas is recognized as an important element in a positive investment environment. Of particular importance in this respect is the investor's freedom to employ top managers regardless of their nationality.

6. (1) Each State will, with respect to private investment in its territory by nationals of the other States:

(a) freely allow regular periodic transfer of a reasonable part of the salaries and wages of foreign personnel; and, on liquidation of the investment or earlier termination of the employment, allow immediate transfer of all savings from such salaries and wages;

(b) freely allow transfer of the net revenues realized from the investment;

(c) allow the transfer of such sums as may be necessary for the payment of debts contracted, or the discharge of other contractual obligations incurred in connection with the investment as they fall due;

(d) on liquidation or sale of the investment (whether covering the investment as a whole or a part thereof), allow the repatriation and transfer of the net proceeds of such liquidation or sale and all accretions thereto all at once; in the exceptional cases where the State faces foreign exchange stringencies, such transfer may as an exception be made in installments within a period which will be as short as possible and will not in any case exceed five years from the date of liquidation or sale, subject to interest as provided for in Section 6 (3) of this Guideline; and

(e) allow the transfer of any other amounts to which the investor is entitled such as those which become due under the conditions provided for in Guidelines IV and V.

(2) Such transfer as provided for in Section 6 (1) of this Guideline will be made (a) in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable currency by the International Monetary Fund or in any other currency accepted by the investor, and (b) at the applicable market rate of exchange at the time of the transfer.

(3) In the case of transfers under Section 6 (1) of this Guideline, and without prejudice to Sections 7 and 8 of Guideline IV where they apply, any delay in effecting the transfers to be made through the central bank (or another authorized public authority) of the host State will be subject to interest at the normal rate applicable to the local currency involved in respect of any period intervening between the date on which such local currency has been provided to the central bank (or the other authorized public authority) for transfer and the date on which the transfer is actually effected.

(4) The provisions set forth in this Guideline with regard to the transfer of capital will also apply to the transfer of any compensation for loss due to war, armed conflict, revolution or insurrection to the extent that such compensation may be due to the investor under applicable law.

7. Each State will permit and facilitate the reinvestment in its territory of the profits realized from existing investments and the proceeds of sale or liquidation of such investments.

8. Each State will take appropriate measures for the prevention and control of corrupt business practices and the promotion of accountability and transparency in its dealings with foreign investors, and will cooperate with other States in developing international procedures and mechanisms to ensure the same.

9. Nothing in this Guideline suggests that a State should provide foreign investors with tax exemptions or other fiscal incentives. Where such incentives are deemed to be justified by the State, they may to the extent possible be automatically granted, directly linked to the type of activity to be encouraged and equally extended to national investors in similar circumstances. Competition among States in pro-

viding such incentives, especially tax exemptions, is not recommended. Reasonable and stable tax rates are deemed to provide a better incentive than exemptions followed by uncertain or excessive rates.

10. Developed and capital surplus States will not obstruct flows of investment from their territories to developing States and are encouraged to adopt appropriate measures to facilitate such flows, including taxation agreements, investment guarantees, technical assistance and the provision of information. Fiscal incentives provided by some investors' governments for the purpose of encouraging investment in developing States are recognized in particular as a possibly effective element in promoting such investment.

IV

EXPROPRIATION AND UNILATERAL ALTERATIONS OR TERMINATION OF CONTRACTS

1. A State may not expropriate or otherwise take in whole or in part a foreign private investment in its territory, or take measures which have similar effects, except where this is done in accordance with applicable legal procedures, in pursuance in good faith of a public purpose, without discrimination on the basis of nationality and against the payment of appropriate compensation.

2. Compensation for a specific investment taken by the State will, according to the details provided below, be deemed "appropriate" if it is adequate, effective and prompt.

3. Compensation will be deemed "adequate" if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.

4. Determination of the "fair market value" will be acceptable if conducted according to a method agreed by the State and the foreign investor (hereinafter referred to as the parties) or by a tribunal or another body designated by the parties.

5. In the absence of a determination agreed by, or based on the agreement of, the parties, the fair market value will be acceptable if determined by the State according to reasonable criteria related to the market value of the investment, i.e., in an amount that a willing buyer would normally pay to a willing seller after taking into account the

nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case.

6. Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined and as an illustration of the reasonable determination by a State of the market value of the investment under Section 5 above, such determination will be deemed reasonable if conducted as follows:

(i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value;
(ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value;
(iii) for other assets, on the basis of (a) the replacement value or (b) the book value in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable replacement value.

For the purpose of this provision:

-a "*going concern*" means an enterprise consisting of income-producing assets which has been in operation for a sufficient period of time to generate the data required for the calculation of future income and which could have been expected with reasonable certainty, if the taking had not occurred, to continue producing legitimate income over the course of its economic life in the general circumstances following the taking by the State;

-"*discounted cash flow value*" means the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under realistic circumstances. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value;

-"*liquidation value*" means the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet;

-"*replacement value*" means the cash amount required to replace the individual assets of the enterprise in their actual state as of the date of the taking; and

-"*book value*" means the difference between the enterprise's assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost after deducting accumulated depreciation in accordance with generally accepted accounting principles.

7. Compensation will be deemed "effective" if it is paid in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable by the International Monetary Fund or in any other currency accepted by the investor.

8. Compensation will be deemed to be "prompt" in normal circumstances if paid without delay. In cases where the State faces exceptional circumstances, as reflected in an arrangement for the use of the resources of the International Monetary Fund or under similar objective circumstances of established foreign exchange stringencies, compensation in the currency designated under Section 7 above may be paid in installments within a period which will be as short as possible and which will not in any case exceed five years from the time of the taking, provided that reasonable, market-related interest applies to the deferred payments in the same currency.

9. Compensation according to the above criteria will not be due, or will be reduced in case the investment is taken by the State as a sanction against an investor who has violated the State's law and regulations which have been in force prior to the taking, as such violation is determined by a court of law. Further disputes regarding claims for compensation in such a case will be settled in accordance with the provisions of Guideline V.

10. In case of comprehensive non-discriminatory nationalizations effected in the process of large scale social reforms under exceptional circumstances of revolution, war and similar exigencies, the compensation may be determined through negotiations between the host State and the investors' home State and failing this, through international arbitration.

11. The provisions of Section 1 of this Guideline will apply with respect to the conditions under which a State may unilaterally termi-

nate, amend or otherwise disclaim liability under a contract with a foreign private investor for other than commercial reasons, i.e., where the State acts as a sovereign and not as a contracting party. Compensation due to the investor in such cases will be determined in the light of the provisions of Sections 2 to 9 of this Guideline. Liability for repudiation of contract for commercial reasons, i.e., where the State acts as a contracting party, will be determined under the applicable law of the contract.

V
SETTLEMENT OF DISPUTES

1. Disputes between private foreign investors and the host State will normally be settled through negotiations between them and failing this, through national courts or through other agreed mechanisms including conciliation and binding independent arbitration.

2. Independent arbitration for the purpose of this Guideline will include any *ad hoc* or institutional arbitration agreed upon in writing by the State and the investor or between the State and the investor's home State where the majority of the arbitrators are not solely appointed by one party to the dispute.

3. In case of agreement on independent arbitration, each State is encouraged to accept the settlement of such disputes through arbitration under the Convention establishing the International Centre for Settlement of Investment Disputes (ICSID) if it is a party to the ICSID Convention or through the "ICSID Additional Facility" if it is not a party to the ICSID Convention.

THE WORLD BANK GROU

(International Bank for Reconstruction and Development, International Finance Corporation, International Development Association, International Centre for Settlement of Investment Disputes and Multilateral Investment Guarantee Agency)

1818 H. Street, N.W.
Washington, D.C. 20433, U.S.A.
Telephone: (202) 477-1234
Facsimile: (202) 477-6391
Telex: WUI 64145 WORLDBANK
RCA 248423 WORLDBK
Cable address:
INTBAFRAD WASHINGTONDC

Design by Timothy Gottrich & Jennifer A. Sterling

0-8213-2[illegible]-2