



12-1-1973

Andean Investment Code

Stanley R. Lisocki

Follow this and additional works at: <http://scholarship.law.nd.edu/ndlr>



Part of the [Law Commons](#)

Recommended Citation

Stanley R. Lisocki, *Andean Investment Code*, 49 Notre Dame L. Rev. 317 (1973).

Available at: <http://scholarship.law.nd.edu/ndlr/vol49/iss2/4>

This Article is brought to you for free and open access by NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.

THE ANDEAN INVESTMENT CODE

*Stanley R. Lisocki**

I. Introduction

The Latin American countries urgently need to improve their deteriorating external trade in the world market. This decline becomes evident with the juxtaposition of the population and trade statistics of Latin America. From 1950 to 1970 the population of Latin America increased from six to approximately ten per cent of the world population, yet during that same period Latin America's participation in world trade dropped from about eight to four and one-half per cent.¹ Efforts to turn about this extremely unfavorable trend have been forthcoming since World War II. One remedy, initiated around 1960, is a dedication to regional integration.

The concept of regional integration displaced the prevailing doctrine of substitution of imports—a national policy which had predominated in Latin American countries since the end of World War II.² Substitution of imports is a policy designed to create jobs in industry and to save foreign exchange through the development of small and medium size national industries protected by a wall of high tariffs, import quotas, and prohibitions. However, a decade of experience had demonstrated that such restrictive trade policies resulted in inefficiently produced goods with a consequent rise in costs. Savings in foreign exchange proved all but illusory because it was necessary to import high-cost machinery and spare parts. This problem was further aggravated by a tendency to overexpand. Moreover, where raw materials were not available locally and had to be imported at a cost disproportionately large compared to the value added in local manufacturing processes, the net effect of this policy would sometimes be to increase rather than reduce foreign exchange expenses.

Regional integration focuses on counteracting the adverse effects of the import substitution trade policy by increasing the size of available markets and facilitating the division and specialization of labor. Thus more efficient production and accelerated economic development will be possible.³ A further objective of the regional trade agreements is to gain greater bargaining power in world trade negotiations.

The idea of Latin American integration was first realized when eleven Western Hemisphere countries organized the Latin American Free Trade Association (LAFTA) in February 1960 by the Montevideo Treaty. Notwithstanding the very satisfactory growth of trade within LAFTA during the first

* Research Associate, Notre Dame Law School; J.U.D., Jagiellonian University, Poland, 1937. Mr. Lisocki was a businessman in Latin America from 1939 to 1972. The kind advice of Father William Lewers, C.S.C., Professor of Law, Notre Dame Law School, and the assistance of Peter Nugent, Notre Dame Law School, class of 1973, in the preparation of the final draft of this article is gratefully acknowledged.

1 J. VALLEJO, *ABC DE LA INTEGRACION LATINO AMERICANA* (1971). Data of CEPAL, Santiago, Chile.

2 R. HILTON, *THE MOVEMENT TOWARD LATIN AMERICAN UNITY* (1969).

3 P. PREBISH, *HACIA UNA DINAMICA DEL DESARROLLO LATINO AMERICANO*. (1963).

years of its existence, the progress of economic integration has been slow and difficult.

There are many reasons why progress has stalled. LAFTA did not adopt the European Common Market system of progressive and automatic tariff reduction, but instead employed a system of product-by-product negotiations. This system worked well initially when discussion centered on products in which only one or two countries had an interest. As an example, Argentina, Brazil, and Colombia found it relatively easy to negotiate reciprocal concessions involving coffee and fine raw wool. Among these three parties, coffee is produced only in Brazil and Colombia, whereas Argentina is the only producer of high-quality wool. Positions soon harden, however, when negotiations turn to a product like woolen piece goods which are manufactured in all three countries. The force of vested interests, unwilling to face new competition, is evidenced at the negotiating table.

Other difficulties encountered include: first, the unstable currency and balance of payments problems, suffered by almost all of the member nations, which did not permit the adoption of free foreign exchange transfers, and, second, the great distances which separated the participating countries coupled with the absence of suitable transportation facilities. Finally, the lack of progress toward integration may be attributed in part to the great disparity in the levels of economic and industrial development attained by the LAFTA countries which, in this regard, divide into three distinct groups: (1) the so-called "big three"—Argentina, Brazil, and Mexico, (2) the intermediate groups, characterized by insufficient markets—Chile, Colombia, Peru, Venezuela, and Uruguay, and (3) the least developed countries—Bolivia, Ecuador, and Paraguay.⁴ This last problem is reflected in the fact that during the first years of LAFTA's existence Argentina and Mexico substantially increased their exports to LAFTA countries while Chile, Colombia, Ecuador, and Peru, all future members of the Andean Common Market, found that their intrazone trade deficit tripled in favor of other LAFTA countries.⁵

These developments coupled with the generally slow progress of LAFTA led the five neighboring Andean countries, Bolivia, Chile, Colombia, Ecuador, and Peru, to create the subregional Andean Common Market (ANCOM). Established by the Cartagena Agreement on May 26, 1969, ANCOM was created with the approval of LAFTA to function as an entity within the free trade area. Later, in February 1973, Venezuela joined the Andean group although reserving the right to remain exempt from tariff reductions on maximum 250 items until 1979.⁶ Although the thrust of ANCOM is similar to LAFTA there are basic differences. Primarily, LAFTA is a scheme for trade agreements in which participating countries will exchange tariff concessions among themselves. The LAFTA agreement establishes no goal of reaching a uniform tariff vis-à-vis outside countries and no fixed obligation to suppress all

4 See Wionczek, *The Rise and the Decline of Latin American Economic Integration*. 9 J. OF COMMON MARKET STUDIES (1970).

5 See THE ANDEAN COMMON MARKET, BUSINESS INTERNATIONAL (1970). Research report published by the Business International Corporation of New York City.

6 Acta final de negociaciones entre la "Comision" y el Gobierno de Venezuela, El Universal (Caracas), February 15, 1971.

the trade barriers presently separating the national markets of the member countries. On the other hand, ANCOM countries adopted a common market structure thereby acquiring an obligation—although certain items were provisionally excepted—to eliminate progressively and automatically the barriers among themselves by December 1980 and to create a common external tariff by December 1985. The purpose of the Andean Common Market is to promote industrial growth within the ANCOM area and to create within LAFTA a bloc which in the future will be able to deal with the “big three” on equal terms.

An appreciation of the economic significance of ANCOM may be gleaned from the following statistics. Comparing gross national products, the G.N.P. of the Andean group including Venezuela during the years 1969-1970 was \$31.2 billion as against \$21.0 billion for Argentina, \$33.7 billion for Brazil, and \$31.6 billion for Mexico.⁷ In 1970 the population of the six countries totaled around 65 million. A publication of the Pan American Union in Washington⁸ projects that by 1985 the population of the Andean countries will reach 100 million people, 70 per cent of whom will live in the cities and 32 per cent of whom will be economically active. The G.N.P., according to the same study, should by 1985 increase to about \$60 billion (real dollar growth)—roughly double their combined G.N.P. of 1969.

In December 1969 the foreign investments of the United States totaled \$70.76 billion of which \$20.00 billion was invested in less developed countries. The book value of United States direct investments in the five founding ANCOM countries exceeded \$2.4 billion on December 31, 1969. In this regard, Venezuela occupies a special position because of the extensive U.S. investments in oil extraction. With U.S. investments amounting to \$2.67 billion on that same date, Venezuela leads Latin America in attracting U.S. capital—trailed by Brazil and Mexico, each with about \$1.63 billion.⁹ Thus, the more than \$5.0 billion invested in ANCOM countries represented 25 per cent of all U.S. investments in the Third World—a very important position which unfortunately since then has been constantly diminishing because of expropriations in Chile and Peru and a general shift in interest from Latin America to Asia and Africa on the part of U.S. investors.

A view supported by some national and foreign advisors¹⁰ is that a prerequisite of a successful regional integration is the establishment of a common policy toward foreign private investments. Pursuant to this view and after extensive study and long discussion, a foreign investment code was approved on December 31, 1970. Officially, it is Decision 24 of the Commission, ANCOM's governing body, and is titled “Common Rules Governing the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties.” (Hereafter referred to as the Investment Code.)

⁷ ANNUAL REPORT, Inter-American Development Bank (1971).

⁸ GRUPO ANDINO, SEPARATO No. 11 (1972).

⁹ U.S. DEPARTMENT OF COMMERCE, THE INTERNATIONAL INVESTMENT POSITION, SURVEY OF CURRENT BUSINESS (1970).

¹⁰ See M. WIONCZEK, LATIN AMERICAN ECONOMIC INTEGRATION (1966).

II. The Investment Code:¹¹ Objectives, Rules, and Definitions

The main objectives of the Investment Code are:

1) To allow the private foreign investor to participate only in those sectors of the economy which cannot yet be served by nationals and which at the same time are considered significant to the economic growth of the host country. In certain key areas new foreign investments will be completely proscribed; also, existing foreign investors will be obliged to gradually reduce their combined equity position in any enterprise to a maximum 20 per cent interest within a specified period of time.

2) To assure that in the future the privilege associated with operating in ANCOM is available only to national or mixed enterprises.¹² This privilege entitles the enterprise to sell goods within the six-country area under conditions of reduced or eliminated tariff barriers. To reach this objective the Investment Code adopts the fade-out principle. Under this scheme the foreign investor who seeks the ANCOM privilege for his enterprise must agree with the appropriate authority that during a specified period of time he will gradually sell off a part of his equity so that his participation is reduced to a minority position at the deadline. The privileged access to the ANCOM market will be accorded to a foreign enterprise in the process of being transformed into a national or mixed one.

3) To regulate and control patents, royalties, and technology transfers. Restrictions on payments for these rights are imposed.

4) To assure that under no circumstances will the foreign investor receive better treatment than that afforded nationals and that no member of ANCOM will give to any foreign investor more favorable treatment than is allowed under the rules established by the Investment Code.

5) To restrict the use of local credit by foreign companies, to limit the use of foreign loans and the rate of interest paid for these loans, and to limit to five per cent the amount of reinvestment allowed to a foreign enterprise.

6) To enforce a principle that any conflict with a foreign investor must be subject to the exclusive jurisdiction of the host country.

7) To forbid any acquisition or takeover by a foreign investor of any existing enterprise in the Andean area and to support the creation of intra-regional, national enterprises.

On the other hand, each participating country guarantees to the foreign investor the right to repatriate dividends up to a maximum 14 per cent of investment, and the right to withdraw the capital and capital gain. Although the Investment Code provides no formal guarantee, the process of agreeing in advance to fade out gives to the foreign investor a certain *de facto* assurance against the risk of future confiscation.

Any new foreign investment in the ANCOM area must be authorized by the appropriate national control office—according to Article Two of the Code,

¹¹ See 1972 INTERNATIONAL LEGAL MATERIALS 126.

¹² Andean Investment Code art. 1.

each country will establish its own.¹³ Registration of all existing investments and authorizations for all agreements required by the Code will be handled by these same offices, each of which must in turn coordinate with the Board of ANCOM which is charged with ensuring the uniform enforcement of the Investment Code. In addition, the Board will gather and analyze information concerning foreign investments, technology arrangements, patents, etc., drawn from the entire Andean area.

It is important to note that the common rules established in the Investment Code provide the minimum restrictions¹⁴ to be applied to foreign investments, while permitting the imposition of further restraints by member countries. Because the Investment Code is not a precise and thoroughly binding codification of principle, but only an agreement on minimum standards, it gives no assurance of future stability. The rules of the game may still change although only in one direction—less favorable to the foreign investor. It would seem that had the participating countries clearly delimited the scope of foreign investment endorsed by the authority of an international treaty instead of the agreement on minimum rules, they would have given the foreign investor, as compensation for the restrictions imposed, an assurance of the stability of the newly adopted rules.

Much of the substance of the rules and objectives of the Investment Code is contained within its definitions. Perhaps most important are the concepts of "mixed company" and "national company." A national company is an enterprise in which at least 80 per cent of the equity is controlled by national investors. A mixed company is an enterprise in which at least 51 per cent of the equity belongs to national investors. In both types, management control must actually reflect the proportion of equity ownership. Even though the national equity in an enterprise is 51 or 80 per cent, if this proportion is not reflected in technical, financial and administrative management, the company will be considered foreign. Also, the Investment Code distinguishes between existing foreign enterprises, those established prior to June 30, 1971, and new ones established thereafter. The term "national investor" includes member states, as well as national individuals and enterprises of any ANCOM member. A foreign citizen, with a minimum consecutive residence of one year in the host country, who renounces the right to transfer profits abroad or to re-export his invested capital is also a national investor.

The following are subject to agreement between the foreign enterprise and the control office of any member country within whose territory the existing or new industry is established: the method of determining the value of the shares at the time of required sale; the process of ensuring the progressive participation of national investors in the management of the company; and the period of time in which foreign investors must partially divest ownership. Although the maximum time period for fully effecting the transformation will also be established in the agreement, the process must be completed within 15 years in Colombia, Chile, Peru, and Venezuela and within 20 years in Ecuador and Bolivia, who because of their lesser stage of development are allowed to apply this

¹³ *Id.* art. 2.

¹⁴ Oliver, *The Andean Investment Code*, 66 AM. J. OF INT'L L. 763 (1972).

extended period. Agreements to gradually transform into a mixed enterprise concluded within the more developed countries must stipulate that the equity participation of national investors will be not less than 15 per cent at the time production begins, not less than 30 per cent at the end of the first third of the agreed transformation period, and not less than 45 per cent upon the expiration of two thirds of that period. In the case of the less developed countries, Bolivia and Ecuador, these percentages are reduced.

The existing foreign company, not agreeing to the fade-out of foreign control, but which is not operating in an economic sector reserved exclusively to nationals may continue to operate provided at least 15 per cent of its shares are held by national investors. In this case, as indicated earlier, the company will not be accorded the privilege of the common market. As previously observed, since the Investment Code sets down only minimum restrictions, there is no guarantee that the fade-out principle will not, on a country-by-country basis, be later extended to the old industries.

Moreover, the existing foreign enterprise has three years from the effective date of the Investment Code to decide whether it wants to be transformed into a mixed or national enterprise and thereby gain access to the common market. Whatever the decision, before the three-year period ends the company must ensure that at least 15 per cent of its equity is owned by national investors.

No establishment of a new foreign enterprise or new direct foreign investment will be permitted in the public-service sector, *i.e.*, water, electric power, telecommunication, etc. New foreign investment will also be refused in commercial banks or other financial institutions, domestic transportation, newspapers, television, and in the sectors of insurance, advertising and domestic marketing. As originally formulated, existing foreign banks were required to cease receiving local deposits of any type within three years from the date on which the Investment Code was promulgated if during that period they failed to attain national company status, *i.e.*, 80 per cent of equity held by national investors. This provision came under heavy attack in Colombia and finally was modified allowing each country to apply differing regulations adapted to its own circumstances.¹⁵ A foreign enterprise which presently operates in these restricted sectors must convert into a national enterprise within a period not exceeding three years. Each member country may also reserve additional sectors of economic activity for national enterprises, public or private, and, in addition, determine whether mixed companies shall be admitted to these added sectors.

In summary, the basic restrictions fall on old and new enterprises with much the same effect. The concessions granted to existing enterprises are: 1) in the key areas, where entry of new investment is prohibited, the existing investor may retain 20 per cent ownership and may, in certain cases, obtain local permission to retain 49 per cent; 2) in other areas the old company may remain "foreign" conserving 85 per cent of the equity in the hands of foreign investors, provided it relinquishes the privilege of the common market.

Supplementing the rules set forth in this section are certain exceptions con-

15 The corresponding Article 42 of the Code was modified in this sense by a decision of the Commission of Cartagena Agreement in 1972, after it was modified by the Colombian Congress before the ratification of the Cartagena Agreement.

cerning enterprises dedicated to basic products and mixed companies having the state as a partner. Discussion of these exceptions has been postponed to the following section. Only cursory mention has been made of the very strict controls applied to industrial property, trademarks, patents, and licenses as these are not investments of capital, and thus, lie outside the scope of this article. These aspects are defined by articles 18 to 26 of the Investment Code.

III. Origin and Background

It seems that the Board of the Andean Common Market which proposed the Investment Code went further in restricting foreign capital than was the intention of the creators of the Andean pact itself. It had been agreed in Cartagena that a uniform treatment of foreign capital must be established. However, Dr. Vallejo, Colombian Minister of Economy who represented Colombia at the initial negotiations of ANCOM and was one of the main promoters of the Cartagena Agreement, declared that the main reason for this restrictiveness was the fear of a war of incentives among Andean countries to attract foreign capital.¹⁶ According to Minister Vallejo, the idea was to attract foreign capital to each country under the same conditions, to establish the maximum incentives, and to regulate only the functions of the foreign capital, licenses, and patents.

The Board, with its advisors, proposed investment regulations which substantially distorted the original intent of the Cartagena Agreement, at least on the Colombian side. It seems to have been influenced by legislation existing in Mexico called "Mexicanization" which provides that foreign capital may operate only on a joint-venture basis in which the foreign investor is limited to a maximum 49 per cent of equity.¹⁷ Other obvious influences were the new "Industrial Law" of Peru with its harsh provisions for the foreign "fade-out"¹⁸ and the antiforeign attitude prevailing in Chile and Peru which, to a lesser extent, had already begun to influence Colombian thinking. Board members and advisors also shared the conviction that multinational companies had received excessive advantages from the LAFTA tariff reductions and were determined to prevent ANCOM from becoming a playground for the giant multinational corporations even at the cost of slower economic growth.¹⁹

They responded to the general fear of superior North American technology and efficiency—a fear deeply shared by certain sectors of business community which feel unable to compete with the American technology and research

16 M. Rizo, Colombia and the Andean group in the process of Latin American Integration (1972) (unpublished thesis in Memorial Library, University of Notre Dame).

17 Mexicanization is a set of different governmental rules restricting direct foreign investments operating since 1966. The rules and their interpretation are becoming harsher. These rules are based theoretically on a law existing since 1944 which previously was not applied. The industry is divided into 6 sectors with different principles for foreign investments being applicable to each sector. Generally speaking, a new investment with more than 49% of foreign equity is prohibited. Also local credit for foreign-owned firms has been restricted since 1967. As the Andean Code is based on certain Mexican principles, so, on the other hand, Mexico adopted in 1971 a new law regulating foreign patents, trademarks and royalties based on the Andean Investment Code. See generally MEXICO, OPERATING FOR PROFIT IN A CHANGING MARKET, published by Business International Corp., New York (1971).

18 The so-called "general law for the industries" proclaimed by the Peruvian Military Junta in 1972.

19 THE ANDEAN COMMON MARKET, BUSINESS INTERNATIONAL (1971).

facilities. Following a nationalistic philosophy, ANCOM has decided to deprive foreign capital of its power in the name of sovereignty and keep the common market economy in the full control of its members. Nevertheless, they wanted to bring in new foreign capital, but with no great cost, for limited periods of time, under strict governmental control, within beneficial production areas, and lastly, with total exclusion from the key areas.

Apart from their nationalistic philosophy,²⁰ many of the new and especially the younger economists in Latin America adhere to socialistic economic principles and wish accordingly to increase state control of the economy. Although the Investment Code speaks equally of private nationals or companies and the state, in reality the state is almost always the only available buyer for the shares of a foreign corporation in the process of fading out. Confirmation that future state ownership is one of the real objectives of the Investment Code can be found in Article 36 and Decision 47, which determine that although normally a corporation is considered mixed if the foreign investment does not surpass 49 per cent of capital, the percentage of foreign equity can be increased to 70 per cent if the national partner is the state or a state-owned enterprise on the condition that the state or the entity controlled by the state maintains the "decisive power" in managing the company. This may be achieved by issuing to the state or semi-state entities special voting shares or conceding a veto power.

In the basic-products sector, *i.e.*, the exploitation of minerals, hydrocarbons, pipelines and forests, which until now has been the most important area of economic relations between the United States and Latin America, the Investment Code clearly indicates a preference for authorizing foreign exploitation in association with the recipient state enterprise. In any event, this basic sector will operate mainly under a concession system under which the concession, after a maximum period of twenty years, will revert to the state. The exploitation of hydrocarbons by a foreign enterprise shall be authorized preferably in the form of contracts of association with a state enterprise. But, because this sector is also the most important to the host countries which lack the capital or skill to initiate operations themselves, the Investment Code is more liberal in this area allowing concessions for specified periods without national participation. Concessions may be granted during the first ten years of the Investment Code's existence and for a maximum twenty-year period.

Finally, though on the surface the Latin Americans appear only to defend their economies from so-called "imperialistic exploitation," they are also, consciously or not, defending their own system of values and cultural pattern which totally differs from North American standards. The foreign enterprise is more powerful and efficient than its Latin American counterpart. Thus, as the business community is presently extending its influence further into the personal sphere of life, the Latins are afraid that if foreign businesses, especially American, were to dominate their social environment, they would eventually lose their own traditional personality and culture.

Returning to the nationalistic sentiments which shaped the Investment

20 See H. JOHNSON, *ECONOMIC NATIONALISM IN OLD AND NEW STATES* (1967).

Code, it is interesting to note the views of Professor Hirschman²¹ who believes that there is too much American investment in the relatively small Latin American market. For this reason, he is of the opinion that existing investments should be reduced in order to promote a general political understanding between the two Americas. Professor Hirschman's opinion that divesting present U.S. investments will improve the general political relations between the United States and Latin America is of great importance. Indeed, in recent years these relations have not been helped at all by disputes between private American investors and the Latin American governments.

Professor Hirschman's article was written in 1969 when the dispute with Peru about the International Petroleum Company began. Some political developments occurring in Latin America in subsequent years may eventually prove the validity of his thesis. Focusing on the relation between United States and Latin America, the American investments amounted in 1967 to 1.255 billion dollars in Chile, representing 24.3 per cent of its GNP. In Peru, American investments amounted to 960 million dollars, representing 20.7 per cent of its GNP, and in Colombia investments of 650 million dollars composed 12.3 per cent of its GNP. The probability is great that these figures have more than a casual relation to the expropriations by Chile and Peru of American investments and the absence of such occurrences by the Colombian Government. Moreover, the antiforeign feelings are less prevalent in Colombia than in the other Latin American countries.²² Further, Argentina, where the American private investments reached 1.244 billion dollars by 1969,²³ has become violently opposed to foreign, mainly American, investors.

On the other hand, according to Professor Wionczek, a Mexican economist and advisor to the Cartagena Agreement and to many less developed countries in Latin America and Africa,²⁴ the nationalizations in the less developed countries are respondings to the political necessities created by political demagoguery, not by any coherent economical strategy. The economical results of expropriations of copper in Chile and of oil in Bolivia in earlier years and the consequent declines in production demonstrate the validity of Professor Wionczek's thesis. Also, according to Professor Wionczek, similar effects caused by nationalization and excessively nationalistic policies are evident in different African countries. The developments in Bolivia and Chile may be compared with the ten per cent to eleven per cent yearly growth rate of Brazil. Although there American investments reached 1.633 billion dollars in 1969 and a basically nationalistic policy is followed, no expropriation policy has been sought and enormous economical success has been achieved. The logical conclusion follows that although a high percentage of foreign investment in a particular country increases political tensions and opens the road to demagoguery, the decision concerning expropriations is purely political and results in negative effects on the economy of the country.

Professor Hirschman proposed the creation of an "International Divest

21 A. Hirschman, *How to Divest in Latin America and Why*, Princeton essay, No. 76, 1969. (Hirschman is a Professor of Political Economy at Harvard University.)

22 M. WIONCZEK, *EL GRUPO ANDINO Y LA INVERSION EXTRANJERA PRIVADA* (1972).

23 U.S. DEPARTMENT OF COMMERCE, *supra* note 9.

24 M. WIONCZEK, *supra* note 22.

Corporation" which with the support of the Inter-American Bank or some other international financial institution would buy from existing investors certain quantities of American-owned shares and resell them to national investors on a long-term credit basis. Under his proposal, to improve income distribution, a preference would be given by first offering these shares to the people who work for the corresponding companies or, in any event, to as many small investors as possible. This plan also includes the possibility of arriving at fixed arrangements for divesting within a specified period of time.²⁵ In his essay Professor Hirschman mentions that his views are shared by Professor Paul Rosenstein of M.I.T. who one year later became the official advisor to the Board which proposed the Investment Code. It is interesting to observe that the drafters of the Code were influenced not only by Latin American nationalism but also by some well-known American scholars whose opinions were derived from another perspective.

It should be stressed that while Hirschman's proposal was directed at existing foreign investments, the Investment Code took the further and perhaps precarious step of applying the divestiture requirement to future investments as well as subjecting them to other restrictions. The Board was probably of the view that these steps would not result in a severe loss of new foreign investments because of the offsetting attraction inherent in the new common market.

In an effort to evaluate the significance of this wider market, it will be helpful to set forth some statistics bearing on intrazone trade. In 1969 the trade among the five original ANCOM countries did not reach 3 per cent of their total external trade. During 1970 it improved significantly. With ANCOM tariff reductions not yet in effect, intrazone trade reached a total of \$120.4 million, an average annual increase of about 30 per cent during the 1968-70 period, according to the annual report of Inter-American Development Bank.

The data for Venezuelan exports to ANCOM countries was not included in these ANCOM statistics as Venezuela did not join the Andean Common Market until February 1973. Whatever the figures, the percentage of Venezuela's export trade with ANCOM was surely insignificant in light of the fact that about 95 per cent of Venezuelan exports consist of petroleum and iron ore—products which are not imported by ANCOM countries. To reflect the present state of trade development within ANCOM, it may be helpful to compare Colombia's intrazone trade with its trade with the United States. In 1972 Colombia exported 7 per cent of its total trade to member countries while importing 4.1 per cent from them. On the other hand, Colombia's trade with the United States amounted to 33 per cent of her exports and 41 per cent of her imports. Colombian exports to all the Andean countries have been growing during the last years even before the first tariff reductions were effective; they amounted to \$44 million in 1970, \$57 million in 1971 and \$82 million in 1972.

Figures on the development of trade resulting from similar trade agreements should indicate ANCOM's potential. For instance, the intraregional

25 The author has no direct knowledge why Professor Hirschman's proposal was not put to trial; but comparing the enormous needs of Latin American countries to the relatively limited resources of international financial institutions, it appears that this project was not of sufficient priority. Although it has political advantages, it has little economic merit for development.

trade within LAFTA countries doubled within the first six years and later increased at a rate of about 10 per cent annually. The Central American Common Market (CACM) was initially far more successful than LAFTA with intra-regional trade increasing at an annual rate of about 35 per cent from 1961 to 1968 although political troubles have reversed this trend. Lastly, the Caribbean Free Trade Association (CARIFTA) has increased intrazonal exports 27 per cent annually compared with its combined 11.7 per cent growth rate for total exports.²⁶

IV. Reaction and Consequences

One problem which arises when several countries of different political orientations attempt to adopt common regulations for foreign investment is that governments who represent a more radical point of view are more emotionally involved and seek to impose their perspective upon the moderate-thinking governments. Apart from emotion, there is a very practical reason for this pressure.²⁷ It is obvious that if the radicals were determined to impose harsh regulations on foreign investors, other countries within the common market which maintained a middle-of-the-road approach would be the preferred site of multinational corporations with their accompanying know-how and technology. According to different private sources, this was determinative in developing the Investment Code.

The first reaction to the Investment Code rules came from the Colombian private sector which approved the fade-out and joint-venture concepts in a limited form only and opposed many of the other provisions of the Investment Code. The private sector—more realistic in its understanding of the critical role played by new foreign capital, know-how, progressive management, and technology in the process of economic development—feared that the provisions of the Investment Code would cause a substantial decrease in the interest of foreign investors in the Andean area and especially in Colombia.²⁸

The fact is that as a result of a prevailing antagonism toward the foreign investor in recent years and a general lack of confidence in the stability of governmental regulations, the inflow of investment capital into many Latin American countries has been very low. For instance, Colombia which should have far more ability to attract foreign investment than other member countries of ANCOM, due to the recent political events in Chile and Peru, has also been failing to attract foreign investors. Direct foreign investment in the Colombian manufacturing sector dropped from about \$20 million per year in the 1967-69 period to approximately \$7.5 million in 1970,²⁹ although it seems this situation has improved in the last two years.

26 Socio-economic progress in Latin America, ANNUAL REPORT, Interamerican Development Bank (1971).

27 Hirschman and Behrman, *Sharing International Production through the Multinational Enterprise and Regional Integration*, LAW AND POLICY IN INTERNATIONAL BUSINESS (1972).

28 How will multinational firms react to the Andean Pacts Decision 24? INTERAMERICAN AFFAIRS, Vol. XXV, No. 2, 1971.

29 INFORME SOBRE LA INVERSION PRIVADA EXTRANJERA EN COLOMBIA, DEPARTAMENTO ADMINISTRATIVO NACIONAL DE PLANEACION (1971).

Adverse reaction in Colombia culminated in an effort to prevent Investment Code approval. Opponents questioned whether the discrimination between foreign and national investors was constitutional and legal within the norm of international law. The legal argument was lost on the ground that a sovereign state possesses the inherent right to dictate in advance provisions which it considers convenient. However, the court did decide that the Investment Code must be ratified by the Congress which later occurred. A rule which provides that "[m]ember countries shall not grant to foreign investors any treatment more favorable than that granted to national investors," and in the same breath dictates severe and discriminatory treatment for foreign investors must be considered if not illegal, at least unjust. The pragmatic justification for this type of discrimination is that the disproportion of strength between the local capital of Andean countries and that of the multinational corporations has justified lesser developed countries in taking certain measures in self-defense.

During the last national assembly in October 1972, ANDI, the Colombian Association of Industry, approved an official declaration which provides: (1) that the role which a multinational corporation plays in the economic development, particularly in manufacturing products which can be exported to third countries, is essential, (2) that the Investment Code in its present form endangers the probability of new foreign investments, and (3) that Colombia should as a sovereign nation retain the right to determine in specific cases whether the investment of a multinational corporation on a joint venture basis, but with a majority of foreign equity, is convenient for the country. In view of the foregoing, ANDI declared that it will continue to make all possible efforts to change the Investment Code regulations.³⁰ It is extremely doubtful that ANDI will be able to win this point since any determined effort by Colombia to alter the Investment Code may very well risk the destruction of ANCOM unity. The ANDI declaration, although not explicit, clearly implies that the political realities are such that the Investment Code decisions have been imposed on Colombia by other ANCOM countries.

There is another negative consequence of the Investment Code policy which would influence all but the most highly emotional nationalists. The main weaknesses of less developed countries are a lack of capital for investments and a scarcity of foreign exchange. In this situation it seems quite illogical to spend national capital to buy existing foreign enterprises, paying in foreign currency, rather than dedicate this money to build new enterprises. It is true that dividends, royalties, and interest have come to be a very heavy burden on Latin American economies, but this aspect can and should be regulated. Four years prior to the Investment Code, Colombia had established such controls and her experience is enlightening. Although remittance of dividends was permitted up to 14 per cent of investment (the Investment Code rule was based on this law) transfers during the past few years have reached only 7.2 per cent of the total book value of foreign investments.³¹

Moreover, those antagonists of foreign investment who argue that the re-

30 ANDI. DECLARACION DE LA XXVIII ASAMBLEA. Manizales. Octubre 1972.

31 M. Rizo, *supra* note 16.

mittance of dividends places an undue burden on the external balance of payments, fail to take into consideration an important secondary effect of foreign investments—especially those made by multinational corporations. The experience of Latin America clearly shows that multinational corporations produce a much greater proportion of goods for export than do their national counterparts. For this reason, the Colombian law which established limitations on the transfer of dividends also provided a system in which new foreign investors were required to obtain approval of their investments.³² In this way foreign capital was channeled into sectors of interest to Colombia. In establishing these controls the Colombian government was realistic enough not to impose any obligation upon the foreign investor to become a minority partner. Their primary purpose was to attract foreign capital to those sectors of the economy where it would produce the greatest benefit for the country.

There is yet another aspect of the Investment Code which has privately worried the national business leaders. Considering the very small availability of private capital in the less developed countries,³³ the general lack of confidence in the stock market and the traditional tendency to invest in real estate, mortgages, bonds, and similar values, there will be few practical possibilities of transferring foreign-owned shares to the private national investor. The only possible buyer will be the state especially in view of the fact that almost all the shares of old enterprises will come on the market at the same time. The private sector has reasoned rightly that the practical result of the Investment Code will be an increased ownership and intervention of the state leading to a general decrease of private initiative.

In its original version the proposed Investment Code went so far as to provide that the preferable method of divesting foreign-owned shares was through sale to the government. This statement was suppressed under the pressure of the Colombian business world. In all probability this provision was eliminated from the final draft on the view that the practical result would be the same in any event.

From the foreign investor's point of view the fact that his future partner will generally be the state and not a private shareholder is rather convenient. In South America governments are among the few who have money to invest. Thus it may be easier for the foreign investor, although at first glance it may not seem so, to get a fair price for his divested shares from the state than from private buyers. The stock markets in South America are of very limited capacity. In Colombia for instance where in the past decade only one stock exchange existed in Bogota, the whole volume of yearly movement in bonds and stocks together during the years 1965 to 1968 was oscillating between 513 million and 545 million pesos; the whole volume did not reach 50 million dollars a year.³⁴ The government, if interested in keeping a good reputation abroad, will observe a moral obligation to pay a fair price. Furthermore the basis for determining price may be the subject of an advance agreement with the government. In addition, Latin American governments are interested in long-term goals and once

32 DECRETO LEY 444. Dec. 1944. DIARIO OFICIAL.

33 *Supra* note 28.

34 A. BASCH AND M. KYBAL, CAPITAL MARKETS IN LATIN AMERICA (1970).

these goals are respected, a governmental partner will probably interfere much less in the daily management of the company than a private investor.

Finally the leaders of private enterprise in Colombia feared that as a result of an economic union with Chile, with its Marxist President and socialistic program,³⁵ the Andean pact and the Investment Code would become a Trojan horse introducing state control of all enterprises and slowly bring the economic and social policies of the subregion closer to the socialistic model. It is difficult to ascertain how far and how quickly this process may proceed and what political changes the future may bring, but despite some official governmental declarations, *e.g.*, Cuzco Declaration, March 1971, concerning "ideological pluralism" and "self-determination," this aspect cannot be ignored as a possible deterrent to foreign investment.

The most immediate problem created by the Investment Code decisions is whether a foreign parent corporation, which knows that within a certain time it will become a minority partner, will continue to bring into its Andean subsidiary its constantly developing technology. The Council of the Americas, a U.S. business organization representing corporations which own 85 per cent of the total U.S. private investment in Latin America, is of the opinion that the Investment Code will discourage transfers of technology to a foreign affiliate. If an affiliate was slated for divestiture, few companies would provide their most advanced technology to a future competitor.³⁶

The Council of the Americas also conducted a survey in 1971 on the effects of the proposed Investment Code on the U.S. investors. Of the 202 companies solicited, 56 responded, and 51 (about 90 per cent) indicated that the Investment Code would discourage their investment in the ANCOM countries. Their reactions to the Code were varied with responses ranging from mild to very negative. Should these attitudes hold, the multinational corporations will show less interest in the ANCOM countries and some will simply terminate further investment. Of course, concrete decisions will depend on the particular situation as well as the general climate for foreign investment. The interest of a particular business enterprise in ANCOM will reflect its general interest and need to expand abroad and will be shaped in part by conventional business considerations such as the ratio of risk capital to the expected margin of profit, etc. In the area of oil and mineral exploitation different considerations than conventional business motives may prevail, for instance, the necessity for oil or other minerals for the American economy. On the other hand, in this field the obligation for the foreign investor to become a minority partner does not exist according to article 40 of the Investment Code. Therefore, the government may grant to the foreign investor a full concession provided its duration does not exceed 20 years. The provisions of the Investment Code in this area are less harsh. This is because Andean Governments know that any exploitation on a large scale cannot be accomplished without foreign skill and capital.

There may be yet another important consequence of the Investment Code. The Andean Common Market was created with a view to becoming an economic

35 This article was written prior to the coup in Chile in September 1973.

36 Survey conducted by Harvard Business School Students. M. Rizo, *supra* note 16.

unit sufficiently developed to compete on an equal level with Argentina, Brazil, and Mexico in LAFTA, or perhaps on an even wider free trade area including all of Latin America. If, as seems probable, the most important multinational manufacturing corporations interested in investing in Latin America decide on Brazil, with its open-door policy toward foreign investment, instead of the ANCOM countries, the gap between countries such as Brazil and ANCOM will widen, rather than diminish.

As a consequence of Brazil's economic policies, foreign investments of great importance are taking place there. For example, in 1971 Volkswagen manufactured 295 thousand cars in Brazil, and during the first four months of 1972 its exports reached \$15 million. Significantly, Volkswagen has met with some success in opening up a market for its finished vehicles in Peru.³⁷ It is difficult to imagine that any multinational corporation will contemplate investments of this magnitude under the present rules of the Investment Code, and it is inconceivable that the ANCOM countries will be able to create such enterprises with only their own resources.

If the draftsmen of the Code in reaching their decisions considered Mexico's rule requiring the foreign investor to become a minority partner, they failed to realize that Mexico took this measure at a time when it was far more industrialized than are the ANCOM countries at present. Besides this, the Mexican government is authorized to make exceptions from the "Mexicanization" rule in all cases of foreign investments which are considered especially important to the Mexican economy. Without new foreign investments of capital and technology, the ANCOM countries cannot hope to close this gap.

The most probable outcome of the Investment Code will be that some political leaders will satisfy their nationalistic pride, but the people governed by them may lose a valuable opportunity to increase the pace of their economic progress. Although the ultimate consequences of the Investment Code for the ANCOM countries will probably remain uncertain over the next several years, certain more immediate consequences are reasonably foreseeable. In view of the fact that the tradition and experience in Western legal thinking³⁸ of countries such as Colombia far surpass that found in the majority of underdeveloped nations, particularly those in Asia and Africa, it seems probable that other countries, for good or bad, will follow the example of the Investment Code, and so it will give beginning to a new legal concept of regulations for foreign investments made by groups of less developed countries. Considering the low pre-Code figures for new foreign investment in the manufacturing sector of the Andean countries, the effect of the Investment Code as a precedent for other less developed regions may prove to be of much greater significance to the future of foreign investment in the Third World than its direct economic impact in the Andean area.

On the other hand, the adoption of the Investment Code may also invite consideration of new or completely different solutions. Those multinational corporations which find the new rules unacceptable may try other business

37 THE ECONOMIST, Sept. 2, 1972 at 52.

38 See Oliver, *supra* note 14.

methods, resting on a different legal basis, which will be convenient to them and to the host countries. For instance, "coproduction agreements" through which machinery, technology and managerial skills are sold by the foreign company on an intermediate or long-term basis may be a convenient scheme. The foreign company which sells the package may also participate in profits for a certain period of time—an aspect which may prove quite agreeable to the Latin host countries. This type of arrangement is used by the communist countries in the Third World and by Western countries within the communistic bloc, so it seems to be a method convenient for dealings between groups of countries on different economic and technological levels.

As an alternative, Dr. Carlos Lleras, when he was President of Colombia (1966-70), insisted that what is most needed from the private sector of developed countries is a supply of long-term capital. He was comparing Latin America with the United States of the 19th century when the United States was developing with European capital. Unfortunately for Latin America, conditions have changed and private investors are no longer interested in long-term loans to foreign countries. This type of credit is made available only by International Agencies, such as B.I.D., A.I.D., etc.

A different solution is sought by Japan who has limited investments in Latin America, 350 million dollars at the end of 1967 as compared with 11.667 million dollars of United States investments at the end of 1969. Japan's interest has taken the following form: a minority participation in new enterprises to which Japan contributes part of the capital, technology and administrative skills, machinery, and later a continuous supply of raw materials. Conditions offered are very favorable to the Latin industries with the underlying objective of assuring clients for Japanese exported machinery and raw materials. In the case of some extractive industries, the Japanese machinery is installed by Japanese personnel. Such machinery is made available on long-term credit with repayment made by the purchase of the extracted minerals at discounted prices. With this type of strategy the Japanese are entering the markets without great investments of capital and with little conflict between their objectives and the policy of the Andean Code or similar policies present in Latin America.³⁹

V. Conclusion

In spite of all the obstacles and attendant difficulties facing the foreign investor, there is a powerful argument in favor of the joint venture in countries with strong nationalistic tendencies. The existence of a local partner or, still more, the state as a partner, reduces the popular nationalistic opposition to the multinational corporations, while offering political benefits and knowledge of the local conditions and mentality. Although the Investment Code gives no legal guarantee against expropriation, once the joint venture starts to function according to the provisions of the Investment Code, the influence and the visibility of the foreign investor will be diminished so much that in all probability the

³⁹ Wionczek, *Experiencias del sector privado japonés en América Latina*, OEA-CIES (1971). Article was published by Bco. Nacional de Comercio Exterior.

demagogical and psychological pressures for nationalizations will be alleviated. In the end the multinational corporation may discover that, although it lacks majority control, it may be more pleasant and convenient to work within technical limits, leaving public relations, negotiations with outsiders, and marketing solely to the national partners. If the foreign investor would start to work within these limitations, the Third World's fear of multinational corporate domination may slowly diminish. In the long run this may lead to more foreign investment in which multinational enterprises, albeit with smaller individual participation in each venture, will bring more of their technology to the Third World while continuing to enjoy the fruits of expansion.

William D. Rogers, President of American Society of International Law, puts it this way:

Recent Latin American attitudes toward foreign business are the understandable, perhaps inevitable, culmination of the region's past experiences in world business. The nations of Latin America have concluded that they were exploited by stronger outside forces for three centuries. Now they demand an end to dependency.⁴⁰

It may very well be that the relationships between North and South America would improve once a better balance of economic power is achieved. It may also be that once national or joint enterprises develop the self-sustaining ability to exploit modern technology, the governments of the less developed countries would become more tolerant of future foreign investment. It is clear that the business prospects for multinational corporations under the Investment Code restrictions are far from being as easy or lucrative as they were one or two decades ago. But the times are changing and there is no alternative but to co-operate or abandon the markets of these and probably other countries of the less developed world. Many investors in Mexico found that it is possible to accommodate themselves to the roughly similar rules of "Mexicanization." The future may belong to those who will first accept the reality of the era of nationalism, which will be a fact of life in the developing countries for a long period of time. Success will depend on their adaptability to the new perspective of the Third World.

⁴⁰ Rogers, *Challenge for U.S. Investment in Latin America*, 4 LAW AND POLICY IN INTERNATIONAL BUSINESS 563 (1972).