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FOREIGN EXCHANGE CONTROLS: A SURVEY OF THE LEGAL PROTECTION AVAILABLE TO THE AMERICAN INVESTOR

I. Introduction

An American corporation that contemplates the establishment of a foreign subsidiary or branch office abroad faces an enormous mass of legal and economic problems.¹ The corporate attorney who must examine the foreign investment climate is forced to come to grips with exchange controls which must be analyzed for their effect upon the repatriation of capital, the remittance of profits, the availability of foreign currency to pay debts, and the import and export of crucial materials and products.

Exchange controls are a powerful and pervasive form of regulation by foreign governments. Standing alone, such regulation could eliminate all prospects of successful investment by American businessmen in a particular foreign country. Coupled with advantageous investment incentive laws and a flexible government attitude to American investment, however, exchange controls can become less burdensome and sometimes even evolve into incentives for investment.

After an initial examination of the structure of exchange controls, this article will focus upon the protection devices with which an American investor can shield himself from unreasonable foreign exchange control regulation and administration.

II. Background

Direct investment abroad is defined as a "transfer of resources from one country (country of origin) to another (host country), accompanied by substantial control of the enterprise in the host country by the sponsoring concern in the country of origin."² Although branch offices and licensing agreements are common forms of direct foreign investment, the classic pattern is the establishment by an American corporation (the sponsor) of a wholly owned subsidiary in a foreign country.

Since World War II, the United States has made significant dollar transfers abroad in the form of military expenditure, foreign aid, and tourist expense as well as corporate direct foreign investment. Largely because of domestic inflation, these expenditures have led to a drastic balance of payments deficit which has been crucial in two dollar devaluations in the last two years and a dramatic drop in the demand for the dollar abroad. The United States Government has taken various steps besides devaluation to reverse the balance of payments skid. These measures have included government intervention in international transactions to slow investment abroad by American corporations.³

The choice to restrict corporate direct foreign investment was deplored from

¹ See Bruno, *Checklist for Formation of a Foreign Subsidiary*, 24 BUS. LAW. 493 (1969).

² G. FULDA & W. SCHWARTZ, REGULATION OF INTERNATIONAL TRADE AND INVESTMENT 567 (1970).

³ For analysis of the various measures see Note, *Government Regulation of Foreign Investment*, 47 TEXAS L. REV. 421 (1969).

the outset. Direct foreign investment, unlike expenditures for military, foreign aid, and tourism, makes substantial long-range contributions to the U.S. balance of payments by way of dividends repatriated, interest and royalty payments to the sponsor, and exports of components and raw materials to be used in production abroad.⁴ Overseas investment has replaced the export-import account as the prime contributor to the credit side of the nation's balance of payments.⁵

Since direct foreign investment by American corporations is so beneficial to the U.S. balance of payments position, it is understandable that U.S. foreign investment is extremely detrimental to the host country's balance of payments situation. Severe balance of payments deficits and foreign exchange shortages are common phenomena in both industrially developed and developing countries. Of the measures adopted to deal with these problems, the most widely used method is a system of exchange control. Of the one hundred twenty-five members of the International Monetary Fund (IMF) eighty-two member states maintain exchange controls on current transactions and the remaining states could receive approval for current restrictions at any time under the IMF's Articles of Agreement.⁶ The IMF's *Twenty-Third Annual Report on Exchange Restrictions* (1972) lists one hundred twenty-three countries which have exchange control regulations of varying kinds and intensities, most of which exceed restrictions on current transactions.

Foreign exchange control has been a significant factor on the international financial scene since the end of World War II. In the mid 1950's the domination of such measures waned considerably as manifested by a move to full convertibility by several European states.⁷ Recent years have witnessed a revival of exchange regulations for the purpose of maintaining governmental control of international transactions during the severe monetary strain of the late 1960's and early 1970's.⁸

All exchange control rules in their origin and purpose are essentially the same.⁹ When the demand in the host country for foreign currency (especially the U.S. dollar) far exceeded the demand for the local currency, the host government rationed the use of foreign currency. Foreign currency was distributed according to government prescribed priorities and purposes. As time passed, the emphasis in developed countries shifted so that today the object of exchange controls is to protect the balance of payments position of foreign countries by preventing a

4 C. FULDA & W. SCHWARTZ, *supra* note 2, at 620.

5 Twenty years ago direct investment outflow exceeded investment income by several billion dollars, but in recent years the trend has reversed. In the past six years (through fiscal 1972) overseas investment produced a net credit of \$29.8 billion to the U.S. balance of payments. Overseas Private Investment Corp. Ann. Rep. 2 (1972).

6 F. MANN, *THE LEGAL ASPECTS OF MONEY* 545 (3rd ed. 1971).

7 A. FATOUROS, *GOVERNMENT GUARANTEES TO FOREIGN INVESTORS* 47 n.50 (1962).

8 International Monetary Fund, *Twenty-third Ann. Rep. on Exchange Restrictions* 2-13 (1972) [hereinafter cited as 1972 Exchange Restrictions].

9 See BANK OF ENGLAND, *A GUIDE TO UNITED KINGDOM EXCHANGE CONTROLS* 4 (1972); A. FATOUROS, *supra* note 7, at 47; C. FULDA & W. SCHWARTZ, *supra* note 2, at 569, 596; JOINT COMMITTEE ON CONTINUING LEGAL EDUCATION, *A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS* 200 (W. Surrey & C. Shaw ed. 1963) [hereinafter cited as *INTERNATIONAL BUSINESS TRANSACTIONS*].

flight of capital. This in turn necessitates control of current payments abroad.¹⁰

The United States has no exchange control restrictions on current transactions and the movement of capital,¹¹ but the U.S. overseas investor, faced with a myriad of laws in almost all the other countries of the world, must be versed in the principles and procedures of these regulations since they vitally affect any decision to invest overseas.

The American foreign investor wants to obtain from the foreign nation advance approval to withdraw current profits and ultimately to withdraw the capital invested at its appreciated value. Unconditional approval is always difficult to obtain.¹² The investor-sponsor must have some assurances, however, since it will be required to pay U.S. taxes on the foreign enterprise in dollars.¹³ Further, the foreign enterprise will require foreign currency for the purchase of supplies and raw materials from countries outside of the host country; the enterprise will have to pay earnings to the suppliers of capital, interest to creditors, and royalty payments to licensors. Finally, capital must be returned to the owners in the country of origin when the investment is liquidated.

III. General Traits of Exchange Regulations

Generally speaking, restrictions on the repatriation of capital are more severe and more widespread than those on the transfer of interest, profits, and royalties. In many countries, the repatriation of profits is free, *i.e.*, no upper limit is set on the percentage of profits in relation to capital investment that may be repatriated each year. Other countries will set a percentage limit, and still others will impose freedom of transfer conditional upon the political and economic situation.¹⁴

One of the universal features of exchange control legislation is that the legislation is usually pervasive and all-encompassing while the regulations enacted

10 Other collateral purposes that are served by the same basic machinery are the promotion of exports which cannot otherwise compete on the domestic and world markets, the protection of domestic producers from international competition, the influence of domestic patterns of consumption, production, and investment, and the promotion of foreign policy by influencing the direction of trade and investment. *INTERNATIONAL BUSINESS TRANSACTIONS* 204.

11 There are restrictions on transactions with or involving Cuba, North Korea, North Viet Nam, and Rhodesia. 1972 Exchange Restrictions, *supra* note 8, at 448. The United States does maintain import restrictions and export licensing requirements on certain products and to certain destinations like U.S.S.R., Cuba, and North Korea, to name a few. *Id.* at 444-53. Title II of the Currency and Foreign Transactions Reporting Act, 31 U.S.C. §§ 1051-122, put into effect strict reporting procedures with respect to foreign transactions. Banking and financial institutions are to be the prime reporting entities under this legislation, which is ostensibly aimed at curbing tax evasion. The law's supervisory effect appears to be a first step toward exchange control but this law itself admonishes that there must be "due regard for the need to avoid impeding or controlling the export or import of currency or other monetary instruments" as well as due regard "for the need to avoid burdening unreasonably persons who legitimately engage in transactions with foreign financial agencies." 31 U.S.C.A. § 1121a (Supp. 1973).

12 *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 9, at 200.

13 Int. Rev. Code of 1954, § 6316.

14 Panama is an unusual country in that it permits complete freedom in foreign exchange transactions. 1972 Exchange Restrictions, *supra* note 8, at 270. Liberia has an almost identical position. *Id.* at 340. Both economies rely heavily on the dollar. Afghanistan is a country with conditional freedom of exchange. Profit may be remitted annually up to an amount which does not exceed 25 percent of the total capital investment made. J. HENDERSON, *FOREIGN INVESTMENT LAWS AND AGRICULTURE* 94 (1970) [hereinafter cited as HENDERSON]. 1972 Exchange Restrictions 22.

under such legislation are usually quite permissive. However, these regulations are subject to change without notice so that the door may slam shut at any time. If the host countries determine that it is in their best interests to freeze foreign monies in their countries, they have the enabling legislation already at their disposal. They need only supply the appropriate decree.¹⁵

Conditions regarding capital repatriation may affect amounts, time periods, or both. Presumably, this prevents sudden winding-up of an enterprise with the consequence of a sudden large-scale outflow of foreign currency. Also, some capital must usually be left behind in order to provide for contingent or unforeseen obligations which appear after an end of the foreign investment.¹⁶

While much investment legislation refers only to the repatriation of capital and profits, some laws make specific provision for transfer abroad of royalties and fees for the use of trademarks and patents.¹⁷ Royalties and licensing fees often are as important to the American investor as capital itself. Several countries will also permit payment of insurance premiums and amounts representing depreciation provided that this is not intended as permanent repatriation of capital. In countries where such transfers are permitted, it is advantageous for the American investor to have listed the exact assets which can be transferred. If the regulations are silent on these *extras*, they may rightly be the subject of a private agreement between the host government and the American investor.¹⁸

If a foreign investment is expropriated and compensation is paid, the foreign investor should have the right to repatriate the money paid as compensation. Unfortunately, many exchange control laws are silent on provisions of this kind. This silence probably reflects a hesitancy to admit to any premeditation on the notion of expropriation. The American who is fearful of expropriation would clearly prefer some private agreement on compensation sums where the investment laws are silent. Such a private agreement can be modeled after the provisions in Iran and Indonesia which allow repatriation of compensation monies after expropriation despite embargoes on normal capital transfers.¹⁹

If the employment of American personnel is contemplated for a foreign enterprise, these employees will no doubt have to meet family and financial commitments in the United States. They must be able to repatriate at least part of their earnings. Many countries are willing to make concessions in this area, but some restrictions may nevertheless remain and could cause serious recruiting problems. If the host country places percentage restrictions or forbids the repa-

15 Niger has a conditional repatriation scheme. The President of this Republic may impose restrictions on the usual freedom of foreign transfers, if he deems it necessary to do so in defense of national interests. HENDERSON 95; 1972 Exchange Restrictions 324. In Brazil, profits and dividends are subject to additional income tax whenever average annual remittances of any three-year period exceed certain percentages of invested capital. There is a 40 percent surcharge on repatriated profits which represent 12 to 15 percent of registered capital. This ranges up to a 60 percent surcharge on profits representing more than 25 percent of capital. 1972 Exchange Restrictions 58; HENDERSON 95.

16 See, e.g., Iran. 1972 Exchange Restrictions 217; HENDERSON 99.

17 The IMF annual reports on exchange restrictions categorize these extras as "invisibles."

18 Private agreements with host countries are discussed in greater detail at p. 597 *infra*.

19 HENDERSON 102. Repatriation facilities for profits and capital are generally available to foreigners or non-residents rather than "domestic national" or "resident" investors. Even if an exchange control law applies both to domestic and foreign investment, repatriation facilities are almost always reserved for foreign capital. *Id.* at 107.

triation of savings, employment of local people is thereby encouraged. But if the local economy is not able to furnish qualified managerial and technical personnel, the American sponsor company may have to consider licensing agreements or abandonment of the project altogether in that country.

The exchange control system is usually administered through the national bank of the host country. This bank, if it does not have a complete monopoly, deputizes all the banks in the country. Even when transfer of profits can be made with relative freedom, control is typically exercised over such transfers in the form of administrative approval. Almost all countries require that capital and current foreign transactions pass through the administrative grasp of an authorized or central bank. The bank in turn is responsible to a minister of finance or administrative group who determines national policy and priorities. This supervision allows for constant monitoring of the international cash flow.²⁰

IV. Import Control, Export Premiums and Multiple Exchange Rates

Import quotas, licensing, and high duties are often used as devices to save the host country's foreign exchange. Such prohibitions and restrictions are the handmaidens of exchange control, and they are often used not only to preserve foreign currency but also to protect existing local industries especially in underdeveloped countries.²¹

Import restrictions can act as incentives to the American investor.²² If the American corporation has already established a production facility overseas, import restrictions imposed by the host country on the particular item that the American enterprise is manufacturing will constitute protection for the product against foreign competition. Also, newly developing countries frequently need raw materials, equipment, and goods that are not locally obtainable. If import restrictions are prohibitive, new capital will not be attracted. Thus, a common feature of investment incentive statutes is the granting of special exemptions from import restrictions, licensing, and duties to approved investments.

An American concern very often establishes a subsidiary in a foreign country, *A*, primarily for the purpose of manufacturing goods to be exported to foreign country *B*. Generally, host country *A* would want to encourage exports to improve its balance of payments situation, but there are two reasons why the host country

20 Compare this procedure with the U.S. reporting procedures outlined in note 11 *supra*.

21 Indeed, if the import restrictions are imposed in stages they actually encourage the development of local industry of foreign birth. For example, assume that an American concern abroad imports machinery already fully assembled from the United States, and then the host government imposes restrictions on the import of machinery. If the American concern wishes to maintain its share of the foreign market, it might decide to import components from the United States and open an assembly plant in the foreign country. Gradually the import restrictions may be extended to various assembled component parts and finally to the component units. The American businessman will have to convert his assembly plant to full manufacturing if he wishes to preserve his market. In the final analysis a new local industry has bloomed. *INTERNATIONAL BUSINESS TRANSACTION*, *supra* note 9, at 205; Friedmann & Pugh, *Comparative Analysis*, in *LEGAL ASPECTS OF FOREIGN INVESTMENT* 740 (W. Friedmann & R. Pugh ed. 1959) [hereinafter cited as *Comparative Analysis*].

22 *Comparative Analysis* 740-41; HENDERSON, *supra* note 14, at 109-11. Israel has a typical statute for creating an attractive investment atmosphere. Exemptions on import quotas are given for all machinery and raw materials required to carry on an approved enterprise. *INTERNATIONAL BUSINESS TRANSACTIONS* 206; 1972 Exchange Restrictions 226.

may impose restrictions on the exports by the American foreign subsidiary. First, the host country *A* may fear that payment for the exported goods will not re-enter *A*'s economy, but will go directly to the American parent corporation thus bypassing *A*'s repatriation controls. Secondly, because of national priorities or emergencies, *A*'s government may determine that the product manufactured is one which is needed for consumption locally.

To close the first loophole, the host country can impose certain requirements on the payment terms for exported goods.²³ To meet the second objective of priority for local consumption, a more subtle device of multiple exchange rates is utilized and is often applicable to both imports and exports. When the subsidiary exports its goods, a form of currency is earned which is different from the host country's currency. The exchange control law will typically require that this newly earned currency be converted into the host country's currency at the central or approved bank at the appropriate rate of exchange. This rate can vary with the nature of the export. If the host country wants to limit or eliminate exportation of a certain item because it is considered necessary for local use, the rate of exchange will be very low. Conversely, if the host country wishes to encourage export of a certain product, the exchange rate for the foreign monies will be very favorable.

The same system works well for imports too. Since the American enterprise abroad will require foreign currency to pay for imports from the U.S. and other countries, the central bank, as agent of the government, can vary the rates of exchange according to the item which is imported. Moreover, where such multiple rates structure exists, the rates can usually be amended swiftly by administrative action.²⁴ The American investor must look at the total economic picture of the host country in order to judge on a sufficiently long-range basis what products and industries will be encouraged and what imports and exports will receive favorable governmental treatment.

In 1971, a year of crisis in the international monetary system, there was a marked increase in the use of multiple exchange rates. France led the franc countries into a dual market system with an official market (import, exports, and current transactions), and a financial market for all other transactions (including foreign securities and capital transfers).²⁵ In some cases, multiple rate structures were adopted as a means of influencing capital movements. The multiple exchange rates can be focused on short term speculative capital movements in search of higher interest rates whereas direct exchange controls would retard the long term movement of capital funds directly engaged in building international trade in the form of plant and equipment.²⁶

In the turbulent exchange market conditions prevailing in 1971-72, measures to control capital movements were widespread among industrialized countries.

23 For example, the United Kingdom requires that full value of the goods must be received within six months of shipping unless there is special approval of a longer period of credit. BANK OF ENGLAND, *supra* note 9, at 9; 1972 Exchange Restrictions 439.

24 INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 9, at 201-02.

25 1972 Exchange Restrictions 2.

26 See, SUBCOMM. ON INT'L EXCHANGE AND PAYMENTS, JOINT ECONOMIC COMM., 89TH CONG., 1ST SESS., GUIDELINES FOR IMPROVING THE INTERNATIONAL MONETARY SYSTEM 19 (Comm. Print. 1965).

In most cases, the measures were designed to limit an undesired accumulation of foreign exchange reserves and to reduce the domestic monetary effects of inflows of exchange. This often had the effect of turning around the operation of exchange control, which previously had aimed primarily at preventing unauthorized capital outflows. Where such a reversal occurred, there was usually an accompanying relaxation of restraints over capital outflows. This easing tended to follow after a certain time lag or to be limited to specified types of transactions.²⁷ Among the measures taken to offset the domestic monetary effects of inward capital movements, the majority affected the operations of domestic banking systems, but a major instrument employed for discouraging excessive capital inflows has been the dual exchange market.

The controls introduced over the banking system have comprised direct limitations on the acceptance of nonresident deposits by banks and other financial institutions, and more generally, limitations on the banks' external positions. Among the countries which either introduced or modified such controls were Austria, Belgium-Luxembourg, France, Italy, Japan, the Netherlands, and the United Kingdom.²⁸ In France, banks were instructed to prevent any deterioration in their overall net external position in francs and foreign currency; the banks were therefore obliged to verify the purpose underlying purchase of francs against foreign currencies so as to ensure that the transaction was not motivated by speculative reasons. Such measures sharply curtailed the practice by multi-national corporations of moving excess funds from one financial capital to another in search of favorable conversion rate changes.²⁹

V. Convertibility

When two independent monetary systems exist, the relationship of the host country's monetary system with that of the sponsor nation's involves not only the problem of making payments to the sponsor nation, but also the problem of valuing the one currency in terms of the other. The term "exchange control" tends to infer some notion of a government exercising control over its own currency. But such control is exercised with regard to changing that currency for the currency of another nation. Thus, the idea of exchange control has come to include the concept of convertibility.³⁰ "In its broadest financial sense, a currency may be called convertible if the country of issue does not restrict the person to whom, or the places to which, or the purposes for which it may be transferred."³¹ Absolute convertibility would imply complete absence of exchange restrictions.

27 Among the industrialized countries, Belgium, Luxembourg, France, and the Netherlands used dual exchange markets as a means of stemming capital inflows. Among the countries which relaxed exchange controls or transaction controls to stimulate capital outflows were France, Japan, the Netherlands, and the United Kingdom. 1972 Exchange Restrictions 7-9.

28 *Id.*

29 Avoidance of such exchange controls and a reversal of the speculative capital flows which created the massive money-market disturbances in the early 1970's would require an improvement in market conditions and confidence in the United States so that yield incentives would no longer exist for placement or retention outside the United States of funds that would otherwise tend to be held in this country.

30 INTERNATIONAL BUSINESS TRANSACTIONS 203; F. MANN, *supra* note 6, at 451.

31 INTERNATIONAL BUSINESS TRANSACTIONS 203.

A currency may be partially convertible, or it may be convertible only in certain circumstances, for certain purposes, or by certain people. For instance, *current account convertibility* exists where the host country does not restrict payments and transfer for current international transactions such as merchandise, trade, travel, and profits but does regulate the transfer of capital.³²

Limitations on convertibility are manifested in several ways. Many countries allow transfer of profits only to the country of origin of the investment. The eventual extent of convertibility of repatriated profits depends upon the extent of exchange restrictions upon the currency in which the investment was originally made.³³

Another condition frequently placed upon the repatriation of profits is that the transfer must be made at the rate of exchange existing at the time of transfer. Such a provision could be disastrous to the American investor if he is operating in a host country which suffers from severe inflation. Provisions for periodic revaluation of assets will circumvent this hazard.

The most troublesome convertibility problem is that of defining which rate is to apply to a particular conversion when there are multiple rates in existence. There are at least four different commercial rates as recognized by the Articles of Agreement of the IMF.³⁴ Besides an official rate, the host country often establishes a basic rate to which it superimposes additional rates for purchases of foreign currency derived from special transactions and at which it sells foreign currency needed for certain other transactions.

The reasons for the imposition of varying degrees of inconvertibility are precisely the same as those mentioned for the imposition of exchange controls.³⁵ This is further evidence of the close relationship of the two concepts.

VI. Protection for the American Investor Against Exchange Control Administration

A comparative treatment of the exchange controls of specific countries is unnecessary. "In their kernel, the exchange control regulations of the world are identical, though they may differ in detail."³⁶ Each system of exchange control must necessarily include some degree of flexibility in order to allow the host country to make timely adjustments for the current international economic situation. Thus, any in-depth comparative analysis is bound to become rapidly obsolete. The interested American investor must consult the annual reports on exchange restrictions published by the International Monetary Fund. These reports will in turn direct the investor to the agency or bank in charge of administering the exchange controls in each country, which administrator can clarify and update the regulations.

The existence, or possible future imposition of crippling exchange restrictions

32 "Current account convertibility" is the ultimate contemplated by the IMF's Articles of Agreement. See notes 68-76 *infra* and accompanying text.

33 HENDERSON, *supra* note 14, at 97.

34 See F. MANN, *supra* note 6, at 457-61; Mann, *Problems of the Rate of Exchange*, 8 MOD. L. REV. 177 (1945).

35 Notes 9, 10 *supra* and accompanying text.

36 F. MANN, *supra* note 6, at 379.

constitutes a major barrier to American investment abroad. The imposition of exchange control is not per se unlawful under customary international law and no special rules have evolved to deal with exchange regulations except for treaty law provisions.³⁷ The American investor must have some protection against exchange control restrictions if he is to invest wisely in a foreign country.

A. Private Agreements with Host Countries

Agreements between a capital-importing state and a private business entity from another state are common occurrences in European and developing countries as part of host countries' investment incentive legislation.³⁸ Private agreements may be used to eliminate any or all of the possible noncommercial investment obstacles in a foreign country, but they tend to concentrate upon the three major obstacles of taxation, exchange restrictions, and expropriation.

1. Protection by Statute or Policy Statement

There need not be a contractual basis for the elimination of these barriers. Many states provide special tax incentives, exchange guarantees, and expropriation compensation by statute. Filipino law, for example, by statute guarantees the repatriation of capital, the remittance of earnings and the payment of foreign loans and contracts by a foreign investor. But, like statutory guarantees of most other states, the Filipino guarantees are subject to the emergency control powers of another statute which allows abrogation of the guarantees during a foreign exchange crisis as declared by the host government.³⁹ Further, any codification of incentives (aside from a statute enabling a ministry to enter into private agreements) is, of necessity, couched in very general terms since it is an attempt to encompass a wide spectrum of investments. Such generalities, riddled with exceptions, only embody the pre-existing problems in a new legal form.⁴⁰ Most American firms require a private agreement as a supplement to the legislation.

In several cases the governments of underdeveloped countries merely issue unilateral policy statements which indicate the state's general attitude toward foreign investment and spell out particular policies to be pursued by administrative action. Like treaty promises and foreign investment codes, they are usually drafted in general terms both in regard to content and the persons to whom they are addressed. A specific agreement between the American investor and the host country seems both necessary and desirable.

2. The Private Agreement: The Process and the Product

Since exchange control has become a growing and widespread phenomenon

37 A. FATOUROS, *supra* note 7, at 49; *cf.*, F. MANN, *supra* note 6, at 399-430.

38 If the United States Government issued private agreements, such agreements would be open to constitutional challenge as violative of equal protection guarantees.

39 C. FULDA & W. SCHWARTZ, *supra* note 2, at 699-700 n.3.

40 A. Fatouras, *Legal Security for International Investment*, in *LEGAL ASPECTS OF FOREIGN INVESTMENT* 705 (W. Friedmann & R. Pugh ed. 1959) [hereinafter cited as *Security for Investment*]; see generally A. FATOUROS, *supra* note 7, at 120-28.

on the international financial scene, many countries have been able to vary their exchange control regulations to a large degree in order to encourage foreign investment. Capital importing countries can assure investors that they will be able to repatriate a reasonable amount of their earnings in the currency in which the investment was made by establishing special exemptions to the exchange control regulations and special exchange privileges to select foreign investors.⁴¹ These programs can be established without undermining the general exchange restrictions; they provide the host country with a desired degree of flexibility in their exchange controls. Although the patterns of such programs are diverse, the general pattern is that the proposed investment is reviewed by an administrative screening board which is vested with power to waive exchange control regulations or grant tax exemptions if the foreign investor can meet the requisite qualifications.

In Great Britain for example, H. M. Treasury will allow 30 to 50 percent investment capital to be raised in the United Kingdom if there is potential for a highly beneficial effect on the United Kingdom's balance of payments and if investment is located in a Development or Intermediate Area in the northern sector of the British Isles where the government is anxious to place industry.⁴² This is a typical program to encourage better geographical distribution and proof that incentive agreements can be used to support a government's regional as well as national policies.

The final instrument of approval for exchange control concessions is usually the product of extensive negotiation. By such instrument, the state grants to the investor some or all of the assurances and privileges provided for in an investment law or a policy statement. The investor in turn must accept certain obligations in terms of form, amount, and duration of investment. Usually, the remittance of profits from an approved investment is guaranteed without limitation. Sometimes the agreement will allow only a stated percentage of annual profits to be returned to the American investor.

Transfer of capital is usually subject to greater limitations; commonly, a fixed maximum percentage of capital may be repatriated in any year with the additional limitation that there be no repatriation for an initial period of years. Assurances are generally forthcoming concerning the rights of a specified number of key personnel to transfer their salaries or other compensation abroad, notwithstanding the limitations on hiring such personnel which might otherwise exist under the local law. Some capital importing states have accepted provisions for arbitration of disputes with foreign investors.⁴³ It is a rare case, particularly in developing countries, in which any comprehensive assurances have been granted to protect such invisibles as know-how, trademark, or patent rights.⁴⁴ Import and export restrictions are easily waived. In countries with a system of multiple exchange rates, it is possible and extremely desirable to secure agreement on the rate

⁴¹ *Comparative Analysis* 738.

⁴² BANK OF ENGLAND, *supra* note 9, at 18; C. FULDA & W. SCHWARTZ, *supra* note 2, at 722.

⁴³ R. PUGH, *Legal Protection of International Transactions Against Non-Commercial Risks*, in INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 9, at 308 [hereinafter cited as *Non-Commercial Risks*].

⁴⁴ *Id.* at 309.

to be applied to various transactions.⁴⁵ Hopefully, the agreed-upon rate will be the most stable or the most profitable exchange rate available.

3. Protection Under International Law

Even if the U.S. investor is protected under local law of the host country from various infringements of his rights, he may face considerable difficulty enforcing these rights and obtaining remedies before the various local tribunals and agencies.⁴⁶ For this reason, the American legal advisor must attempt to shape rights under international law.

Instruments of approval, concession agreements, and guarantee agreements all contain to a certain extent the legal character of a contract. But, because they all involve the exercise of sovereign state powers, they contain elements which remove them from the realm of private contract law. Absent a breach of treaty obligation or a subsequent denial of justice (both of which are clearly international offenses) when does the breach by a state of contractual-type obligations to a U.S. corporation amount to a violation of international law?

A considerable number of authorities in international law have agreed that the doctrine of *pacta sunt servanda* should apply to an agreement between a state and an alien.⁴⁷ This doctrine attempts to make such an agreement tantamount to an international treaty; thus, any breach by the state would constitute a violation of international law. The principle is applied in all countries to contracts between private persons, but it has only limited application where a state is party to a contract.⁴⁸ Generally, under the laws relating to "public" contracts in most legal systems, the notion of sovereignty is accounted for by giving the state not only the power but also the right to alter its contractual obligations in order to meet changing conditions and to provide for the community of governed persons. *Pacta sunt servanda* has the drawback of being burdensome to the state in that an allegation that the contracting government failed to fulfill a relatively minor duty under the agreement would become an alleged violation of international law.⁴⁹

Except where the repudiation of the contractual undertaking is obvious, a necessary step in establishing the existence of a breach will be to ascertain what body of law is applicable in accordance with the principles of the conflict of laws. In the common case in which the governing law is the municipal law of the host country, establishing a breach of the agreement under the governing law would not by itself establish a violation of international law. An international wrong

45 HENDERSON 97-98. Iran has a provision in its exchange restriction legislation which allows the central bank to enter into separate agreements with foreign enterprises in which a mutually agreed upon exchange rate is established for the transfer of currency rather than having the transaction governed by the market rate prevailing on the date of the transaction. 1972 Exchange Restrictions, *supra* note 8, at 217.

46 *Non-Commercial Risks* 310-11.

47 Brandon, *Legal Aspects of Private Foreign Investments*, 18 FED. B. J. 288, 337-40 (1958); Domke, *Foreign Nationalization*, 55 AM. J. INT'L L. 585, 597 (1961); Kussam & Leach, *Sovereign Exploitation of Property and Abrogation of Concession Contracts*, 28 FORD. L. REV. 177, 194-214 (1959); Ray, *Law Governing Contracts between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 847 (1960); Schweibel, *International Protection of Contractual Arrangements*, 53 AM. SOC. INT'L L. PROC. 266 (1959).

48 *Security for Investment* 720.

49 *Non-Commercial Risks* 318 n.44.

would be present only if the breach also constituted violation of an obligation under international law.⁵⁰ Under municipal law alone the contracting state will invoke its own legislative or executive acts in justification of the breach of duty.⁵¹

Assuming that a breach can be established under the law governing the contract, when does that breach constitute a violation of international law? The classical theory, as yet incomplete and insufficient,⁵² states that in the absence of treaty provisions or a subsequent denial of justice state measures affecting the contractual rights of an alien are lawful under international law if exercised in the public interest and not invoked in discrimination against the alien as such.⁵³ Furthermore, the breach must be a substantial violation of the alien's rights and manifestly unfair. All breaches are reviewed on a case-by-case basis taking into account all relevant circumstances.⁵⁴

Discrimination would appear to be a highly significant and possibly a controlling factor in establishing a violation of international law.⁵⁵ Another possible ground for establishing an international violation is to show a violation of certain well-accepted general principles of law common to most legal systems. Suggested principles of estoppel, unjust enrichment, and the civil law doctrine of abuse of rights have not as yet been successfully invoked to support an alien's rights in a private agreement although the doctrines are highly favored by the legal writers.⁵⁶

Export and import transactions enjoy not even a limited measure of theoretical protection under international law. Thus, the movement of goods and supplies can be taxed almost capriciously in the public interest of the host country.

4. Value of the Private Agreement

It would appear that the U.S. investor would receive only limited, if any, legal protection by entering into an agreement with a host country. In practice, however, it is one of the most widely used devices and highly desired by American foreign investors.⁵⁷ Large corporations especially refuse to be preoccupied by the lack of legal security in such agreements. The formality and psychology of such instruments are the crucial considerations:

[O]nce specified treatment has been promised to the investor any government action in contravention of it must fulfill certain additional formal conditions. . . . As a rule, legislative, rather than merely administrative, action has to be taken since the guarantees are usually granted by virtue of special legislative provisions. From the standpoint of substance, this makes the decision to act in violation of the guarantees a "top-level" one. The possibility of arbitrary action by minor government officials is thus almost wholly eliminated.⁵⁸

50 *Id.* at 318.

51 Mann, *State Contracts and State Responsibility*, 54 AM. J. INT'L L. 572 (1960); *Non-Commercial Risks* 318-19; *cf.*, *Security for Investment* 720.

52 A. FATOUROS, *supra* note 7, at 247; *Non-Commercial Risks* 320-21.

53 A. FATOUROS, *supra* note 7, at 247. It is generally agreed by the authorities that only the contracting state can be the judge of the character and existence of a public purpose or interest. *Id.* at n.42.

54 *Non-Commercial Risks* 319.

55 *Id.* at 320; *Security for Investment* 719.

56 W. FRIEDMANN, *LEGAL THEORY* 391 (3rd ed. 1953); *Non-Commercial Risks* 320; *Security for Investment* 721-24.

57 *Non-Commercial Risks* 327.

58 *Security for Investment* 724-25 (footnotes omitted).

Also, given a certain degree of good faith on both sides, the parties can deal together at arm's length under considerable stress of circumstances if the body of the agreement reflects the areas in which there is fundamental and secure mutual agreement. The signed document will be the embodiment of long hours of negotiation and a final consensus for cooperation. The psychological and the formal effects coupled together make the private agreement on exchange restrictions an extremely reliable and durable contract despite its limited binding force under international law.

A warning to the American investor is necessary, however. Despite attractive exchange control exemptions, the host country will very rarely give unlimited or unconditional grants.⁵⁹ The investor is advised to look carefully at the total economy of the host country and make his own determination of how long the favored investment areas and industries will retain their elevated status. Also, the balance of payment situation of the host country must be seriously scrutinized and projected since despite the best and fairest treatment by legislatures and review boards, the host country may find it difficult at a future time to allocate the foreign currency to a foreign private investor if the balance of payments deficit becomes severe.⁶⁰

B. Protection by the Articles of Agreement of the IMF

Although there is only limited legal protection available to the U.S. investor under customary international law, it is still possible to modify the body of law applicable to the exchange control situation by way of treaty obligations. The Articles of Agreement of the International Monetary Fund, a giant multilateral treaty, has extensively changed the monetary relationships of member states.

The Articles have imposed well-defined duties upon the participating states, bringing about a concomitant restriction of their sovereignty in currency matters.⁶¹ It is well understood, however, that the assumption of such obligations is itself an exercise of sovereignty.

In a nutshell, member states are bound to avoid restrictions on the making of payments and transfers for current international transactions unless such restrictions are permitted by the Articles or approved by the Board of Directors of the Fund.

1. Distinguishing Current from Capital Transactions

The most important feature of the IMF's Articles of Agreement is what they do not regulate; a member state may impose controls on the outward and inward transfer of *capital*⁶² and nothing prevents discrimination in the application of

59 INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 9, at 200, 202.

60 HENDERSON, *supra* note 14, at 94.

61 J. GOLD, THE INTERNATIONAL MONETARY FUND AND INTERNATIONAL LAW, AN INTRODUCTION 10 (1965); Mann, *Money in Public International Law*, 26 BRIT. Y.B. INT'L L. 265-66 (1949). The legal effect of the Articles of Agreement in the United States, both internally and externally, is examined by Nussbaum, *Exchange Control and the International Monetary Fund*, 59 YALE L.J. 421, 422-23 (1950).

62 Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, art. VI, § 3, 60 STAT. 1409 (1946), T.I.A.S. No. 1501, 2 U.N.T.S. 62.

those controls.⁶³ It is the Fund itself which determines what is a capital transaction and what is a current transaction, and the definition of the latter is fairly inclusive, while that of the former is somewhat restricted. But it is undeniable that the Articles are of no assistance to an American investor in a vital and extensive area of restrictions; *i.e.*, those regarding capital movements.

Article IV, Section 3, says in part that “. . . no member may exercise [capital] controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments . . .”⁶⁴ What becomes crucial is the distinction between *capital* and *current* international transactions.

Article XIX (i) defines current transactions.⁶⁵ Basically, it includes payments in connection with foreign trade and short-term banking and credit facilities.

It has not been necessary for the Fund to adopt detailed interpretations of all of the items in Article XIX (i) even though the Article includes such elusive terms as “other direct investments” and “moderate amount.” The last sentence of Article XIX (i) established a procedure by which the IMF can decide whether specific transactions are considered capital or current. The Fund can thereby arbitrate disputes on a case-by-case basis.

Economists regard the definition of current transactions to be somewhat arbitrary in that a number of the items included in Article XIX (i) would be regarded by them as capital in nature.⁶⁶ Thus, although capital transactions can be freely regulated by the member states, there are three restraints on this exercise of sovereignty. First, certain transactions that would normally be treated as capital in nature have nevertheless been included in Article XIX. Thus, the member states are obliged to treat them as current transactions. Second, any controls that a member imposes to restrict capital transactions may not, according to Article VI, Section 3, be operated in a manner which would tend to restrict current transactions. Third, capital controls must not be operated in a way that will “unduly delay transfers of funds in settlement of commitments.”⁶⁷ This means that if a member wishes to establish machinery for segregating capital and current payments so as to limit the former, it must be careful that the machinery does not unduly slow down the settlement of commitments in respect of the latter. The “undue delay” language of Article VI, Section 3 does not mean that funds sub-

63 INTERNATIONAL MONETARY FUND, SELECTED DECISIONS OF THE EXECUTIVE DIRECTORS AND SELECTED DOCUMENTS OF THE INTERNATIONAL MONETARY FUND 67 (April, 1970).

64 *Id.*

65 Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:

- (1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
- (2) Payments due as interest on loans and as net income from other investments;
- (3) Payments of moderate amount for amortization of loans or for depreciation of direct investments;
- (4) Moderate remittances for family living expenses.

The Fund may, after consultation with members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions. 60 Stat. 1425, T.I.A.S. No. 1501, 2 U.N.T.S. 104.

66 J. GOLD, THE FUND'S CONCEPT OF CONVERTIBILITY 5 (1971); J. GOLD, THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS 13-14 (1965).

67 Art. VI, § 3, 60 Stat. 1409, T.I.A.S. No. 1501, 2 U.N.T.S. 62.

jected to capital controls must nevertheless be freed from those controls in order to permit the use of them in settlement for current transactions.

2. Protection for Current Transactions

Logically, the next question is to what extent current transactions are free of exchange restrictions. The Articles state that a primary aim of the IMF was the "establishment of a multilateral system of payments in respect of current transactions between members and the elimination of foreign exchange restrictions which hamper the growth of world trade."⁶⁸

Article IV, Sections 3 and 4, and Article VIII, Sections 2, 3, and 4 have expressly prohibited three categories of exchange practices, all vitally important to the U. S. investor doing business abroad. The prohibited practices are multiple currency arrangements, restrictions on payments and transfers for current international transactions, and discriminatory currency arrangements.⁶⁹

This seems to be a fairly comprehensive list, and, without more, it would ap-

⁶⁸ Art. I, (iv), 60 Stat. T.I.A.S. No. 1501, 2 U.N.T.S. 40.

⁶⁹ Article IV

Section 3. Foreign exchange dealings based on parity

The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity . . .

Section 4. Obligations regarding exchange stability

(a) Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. 60 Stat. 1404, T.I.A.S. No. 1501, 2 U.N.T.S. 46, 48.

Article VIII

Section 2. *Avoidance of restrictions on current payments*

(a) Subject to the provisions of Article VII, Section 3(b), and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions. . . .

Section 3. *Avoidance of discriminatory currency practices*

No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1, to engage in, any discriminatory currency arrangements or multiple practices except as authorized under this Agreement or approved by the Fund. If such arrangements and practices are engaged in at the date when this Agreement enters into force the member concerned shall consult with the Fund as to their progressive removal. . . .

Section 4. *Convertibility of foreign held balances*

(a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents

(i) that the balances to be bought have been recently acquired as a result of current transactions; or

(ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in the currency of the member making the request or in gold.

(b) The obligation in (a) above shall not apply

(i) when the convertibility of the balances has been restricted consistently with Section 2 of this Article, or Article VI, Section 3; or

(ii) when the balances have accumulated as a result of transactions effected before the removal by a member of restrictions maintained or imposed under Article XIV, Section 2; or

(iii) when the balances have been acquired contrary to the exchange regulations of the member which is asked to buy them; or

(iv) when the currency of the member requesting the purchase has been declared scarce under Article VII, Section 3(a); or

(v) when the member requested to make the purchase is for any reason not entitled to buy currencies of other members from the Fund for its own currency. 60 Stat. 1411-12, T.I.A.S. No. 1501, 2 U.N.T.S. 66, 68, 70.

pear to be all the protection which an American foreign investor could ever hope for. But there is a hitch—all of the above prohibitions do not apply to all members of the IMF. Article XIV, Section 2 of the Articles, provides:

In the post-war transitional period, members may . . . maintain and adapt to changing circumstances . . . restrictions on payments and transfers for current international transactions. Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund; and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability. In particular, members shall withdraw restrictions maintained or imposed under this Section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund.⁷⁰

It is clear from the language of the above Article, that each member determines for itself when the postwar transitional period is over. For most states that period has not yet ended. Until the individual state gives notice to the Fund that it is ready to accept the provisions of Article VIII, Sections 2, 3 and 4, it is not barred from using the three types of prohibited practices. Such states have broad privileges in terms of restrictions on current transactions, discriminatory practices, and multiple exchange rates.

There is some limitation. Article XIV permits a member to maintain and adopt exchange restrictions to changing circumstances. If a member seeks to introduce new and more stringent restrictions than were maintained previously, the state must request prior IMF approval under Article VIII.⁷¹ Important policy considerations enter at this point, and the IMF has been more lenient in interpreting "adaptation" of restrictions as opposed to "introduction" of restrictions for those states which still labor under Article XIV.⁷² Similarly, the Fund will be more lenient toward a state which is still under the operation of Article XIV and which seeks approval for the introduction of restrictions than it would give to a state which has already accepted the prohibitions of Article VIII.⁷³

It is not, however, as if the world were divided into two exclusive groups consisting of Article VIII countries and Article XIV countries. Many obligations overlap both groups and afford some protection. For instance, any change in multiple rates, regardless of scope or nature, must be submitted to the IMF for prior approval.⁷⁴ Also, it is clear that any restrictions maintained or "adapted" under Article XIV can only be used for balance of payments reasons.

Numerically, the number of states which have opted in favor of Article VIII obligations is small numbering only 35 of 125 members of the Fund;⁷⁵ but these

70 60 Stat. 1420, T.I.A.S. No. 1501, 2 U.N.T.S. 92.

71 J. GOLD, *THE I.M.F. AND PRIVATE BUSINESS TRANSACTIONS* 18 (1965).

72 *Id.*

73 *Id.*

74 *Id.* at 19.

75 Appendix I at p. 609 *infra* lists the countries which have accepted Article VIII obligations.

countries collectively account for well over 75 percent of the world trade.⁷⁶ Viewed in these terms, the list is significant.

It must be remembered that the Fund has legal authority to approve restrictive exchange practices even in the case of Article VIII countries. This mechanism itself will provide some notice to the American investor and should insure that such measures are truly emergency in nature, only temporary, and not in excess of what the circumstances dictate for the situation. If the restrictions are otherwise, the corporation, through the U.S. Government, may have legal remedies under international treaty law.

In the final analysis, the legal protection afforded by the IMF's Articles of Agreement is limited and probably would not be the determining factor in a decision of whether or not to invest in a particular host country. The foreign investment planner, however, would be foolish to ignore such protection. Its cumulative effect when coupled with other protection devices may provide all the legal protection which is realistically desirable. The Articles of Agreement of the International Monetary Fund, although purporting to be an instrument providing freedom from exchange controls, are really only the machinery for close supervision of exchange restrictions.

C. *Treaties of Friendship, Commerce, and Navigation (FCN)*

Besides the treaty protection provided by the Articles of Agreement of the IMF, certain bilateral treaties also afford protection for the foreign direct investor from the imposition of sudden exchange control prohibitions. The United States was the first to inaugurate a series of treaties dealing chiefly with the problems of foreign investment; the series started after World War II.⁷⁷

Since the guarantees of the treaties are binding in international law, the American investor is provided with all the machinery of international law in the case of any violation of the treaty terms. Unfortunately, the treaty terms may be evasive and riddled with exceptions because of their general applicability.

1. Typical Terms of FCN Treaties

The primary concern of FCN treaties is the limitation of the fear of expropriation and the provision for compensation if expropriation must occur. There is, however, considerable material in the treaties dealing with the imposition of exchange restrictions.

Generally, FCN treaties contain no provisions against the screening of foreign capital by the host country.⁷⁸ All FCN treaties will contain an article dealing

76 International Monetary Fund, Nineteenth Ann. Rep. on Exchange Restrictions 2 (1968).

77 Appendix II contains a list of countries with which the U.S. has treaties governing exchange control matters. For a brief history of modern commercial treaties, see A. FATOUROS, *supra* note 7, at 92-94; see generally Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805 (1958); Walker, *The Post-War Commercial Treaty Program of the United States*, 73 POL. SC. Q. 57 (1958). Japan, the United Kingdom, and West Germany have treaties similar to the United States' FCN series.

78 *Security for Investment* 706.

specifically with exchange control matters and the language varies only slightly from treaty to treaty.⁷⁹

The section on discriminatory exchange practices is a reiteration of generally accepted principles of international law. The terminology of general prohibitory paragraphs varies somewhat from treaty to treaty, but the exceptions to the prohibition on imposition of exchange restrictions are generally broad enough to provide an effective escape clause for the host government.

The treaties' provisions on the employment of foreign personnel by U.S. investors are unclear. The foreign investor is generally permitted to hire skilled personnel regardless of nationality, but such provisions are easily skirted by the host country's imposition of indirect restrictions on the employment of aliens, for example, by requiring that certain percentages of company payrolls go to nationals.⁸⁰

The treaties ignore the problem of foreign currency depreciation or devaluation, and the generality of the treaties tends to limit the effectiveness of the guarantees included. The promised protection and freedom from government intervention are always qualified by the doctrine of sovereignty of the host country over its monetary affairs.

2. Positive Effects of FCN Treaties

These drawbacks should not negate the positive effects of these treaties. The FCN treaties established a number of conventional legal rules in areas where customary international law was formerly uncertain or non-existent. Under customary rules, each state is given the absolute freedom to regulate its currency; the provisions of the treaty, no matter how qualified, limited or vague, still repre-

⁷⁹ See, e.g., Treaty with Japan on Friendship, Commerce and Navigation, Apr. 2, 1953, [1953] 4 U.S.T. 2063, 2072-73, T.I.A.S. No. 2863:

Article XII

2. Neither party shall impose exchange restrictions as defined in paragraph 5 of the present Article except to the extent necessary to prevent its monetary reserves from falling to a very low level or to effect a moderate increase in very low monetary reserves. It is understood that the provisions of the present Article do not alter the obligations either Party may have to the International Monetary Fund or preclude imposition of particular restrictions whenever the Fund specifically authorizes or requests a party to impose such particular restrictions.
3. If either Party imposes exchange restrictions in accordance with paragraph 2 above, it shall, after making whatever provision may be necessary to assure the availability of foreign exchange for goods and services essential to the health and welfare of its people, make reasonable provision for the withdrawal, in foreign exchange in the currency of the other Party, of: (a) the compensation referred to in Article VI, paragraph 3, of the present Treaty, (b) earnings, whether in the form of salaries, interest, dividends, commissions, royalties, payments for technical services, or otherwise, and (c) amounts for amortization of loans, depreciation of direct investments, and capital transfers, giving consideration to special needs for other transactions. If more than one rate of exchange is in force, the rate applicable to such withdrawals shall be a rate which is specifically approved by the International Monetary Fund for such transactions or, in the absence of a rate so approved, an effective rate which, inclusive of any taxes or surcharges on exchange transfers, is just and reasonable.
4. Exchange restrictions shall not be imposed by either Party in a manner unnecessarily detrimental or arbitrarily discriminatory to the claims, investments, transport, trade, and other interests of the nationals and companies of the other Party, nor to the competitive position thereof.

⁸⁰ *Non-Commercial Risks* 327; *Security for Investment* 707.

sent an improvement for the U.S. investor in his legal relationship with the host country. The treaties are a "step toward stability and predictability for the foreign investor. . . . These means may be of little use in cases of major crises or revolutionary changes, but they provide substantial legal protection in the majority of routine cases of unfair treatment."⁸¹ The treaties restrict the otherwise unlimited power of the state (disregarding the IMF Agreement) to regulate its own monetary policy in that a burden of justification is effectively shifted to the host state, a burden which is, to a certain extent, susceptible of objective proof.⁸²

Secondly, the psychological encouragement discussed in relation to private agreements is appropriate and well worth repeating here. The conclusion of an FCN treaty with a capital importing state is evidence of a recognition by both parties of the value and necessity of private foreign investment and the necessity to provide protection for such investments. "Such a realization and desire are among the best guarantees of fair treatment available to the foreign investor."⁸³

A serious drawback of the bilateral treaty series is its failure to provide significant protection beyond general discriminatory prohibitions against violation by a host state of its specific contractual or semi-contractual assurances granted to private American investors. The linking together of treaty and contractual assurances would be a significant source of protection for the American investor.

D. Guarantees by the United States Government

Since it is the capital-importing states that desire to attract foreign capital, it is usually they who offer legal or financial guarantees to prospective investors. Nevertheless, it has become the policy of certain capital-exporting states to encourage investment abroad by offering financial guarantees to the prospective foreign investors. Since World War II the United States has encouraged American business to invest abroad.⁸⁴ This encouragement stems from both political and economic factors and has assumed the form of contracts between the American investor and the U.S. Government insuring the investor against losses due to certain non-commercial risks.

Formerly, this insurance system was managed by the Agency for International Development (AID) under the Department of State, but since January of 1971 the program has been administered by the Overseas Private Investment Corporation (OPIC)—a government corporation with majority private sector representation on the Board of Directors which is under the policy guidance of the Secretary of State.⁸⁵

The programs which OPIC took over from AID's Office of Private Resources include:

1. Preinvestment assistance in the form of information services and investment counseling;

⁸¹ *Security for Investment* 709.

⁸² A. FATOUROS, *supra* note 7, at 218; *Non-Commercial Risks* 324.

⁸³ *Security for Investment* 709.

⁸⁴ Foreign Assistance Act of 1969, 22 U.S.C. § 2191 (1970).

⁸⁵ Foreign Assistance Act of 1969, 22 U.S.C. § 2191 (1970); OVERSEAS PRIVATE INVESTMENT CORPORATION, AN INTRODUCTION TO OPIC 1, 6 (July 1971) [hereinafter cited as INTRODUCTION TO OPIC].

2. Investment insurance to minimize risks of currency inconvertibility, expropriation, and damage from war, revolution, or insurrection;
3. Investment financing—primarily through guarantees of private loan or equity investments, and to a limited extent, through direct loans of dollars or local foreign currencies.

The convertibility insurance, like all OPIC insurance, is not available in economically developed countries.⁸⁶ Moreover, the convertibility insurance is only available in those underdeveloped countries that have agreed to accept the U.S. investor under such an insurance program. OPIC enters into an agreement with each underdeveloped country. These agreements are diverse, ranging in size from one line to lengthy documents. OPIC usually tries to secure guaranteed rights of subrogation and to insert an international arbitration clause to be run by the World Bank or the International Chamber of Commerce. OPIC, however, unlike an agency which is completely under State Department control is not absolutely compelled to receive these assurances. If OPIC can get other practical assurances which provide protection, it can still enter into agreements with countries that refuse to accept subrogation or arbitration clauses.

Even after OPIC has obtained assurances from the underdeveloped state, the specific project for which the insurance will be issued must receive approval by the host country before any insurance will be undertaken by OPIC. The insurance is not available for an existing investment or for the acquisition of existing enterprises, but it is available for expansion and modernizations.

Investment insurance for convertibility does not cover such risks as the depreciation of a foreign currency vis-à-vis the dollar, a general currency deflation, the default of a purchaser, or normal commercial business risks.⁸⁷ The convertibility insurance is applicable both to transfers of profits and repatriation of capital. The insurance, in essence, protects any rights or guarantees that the American investor has secured from the host government at the time the investment is approved. Applicants for convertibility insurance have the burden of ascertaining the host country's willingness to permit remittance of earnings and repatriation of capital. In many cases, the general exchange regulations promulgated by the host country will be sufficient. But when convertibility is not normally available into dollars, a special approval by the foreign government may be required by OPIC.⁸⁸ This means that if at some time after the insurance is acquired, exchange controls are put into effect or the exchange rate system is changed in the host country, and the investor is not able to convert receipts into

86 Foreign Assistance Act of 1969, 22 U.S.C. § 2191 (1970). OPIC issues a "Country List" semiannually which specifies the underdeveloped countries where convertibility insurance is available. Investment insurance against inconvertibility and expropriation is available for some underdeveloped dependencies of France, the Netherlands, Portugal, and the United Kingdom, which dependencies are not listed on the "Country List."

87 INTERNATIONAL BUSINESS TRANSACTIONS 340; OVERSEAS PRIVATE INVESTMENT CORPORATION, INCENTIVE HANDBOOK—INVESTMENT INSURANCE 1 (July 1971).

88 *Id.* at 9-10; INTERNATIONAL BUSINESS TRANSACTIONS 340.

dollars or can do so only at an intolerable discount,⁸⁹ he may make a claim under the contract of insurance. OPIC can audit the books of an insured foreign investor when a claim is submitted.

Remember that OPIC takes into account the U.S. balance of payments situation both long and short term; "Insurance will be denied for investments involving substantial rich third country procurement unless the procurement can be justified."⁹⁰

The insurance protection is being put to substantial use, however. Disregarding petroleum investment (which is generally not insured), roughly two-thirds of the total yearly new U.S. foreign investment is now being insured.⁹¹ The OPIC semiprivate corporate structure works efficiently. The real limit to the effectiveness of the convertibility insurance program is the statutory confinement to the underdeveloped countries.

VII. Conclusion

At a time when the world is experiencing critical monetary developments, exchange controls are once again returning to vogue. Their effect on convertibility is just as critical to an American investor making a foreign investment decision as are tax considerations. The four protection devices enumerated were each found deficient either in legal force or geographic coverage so that none of them individually was sufficient. The cumulative effect of all of them, however, gives a fairly optimistic picture to the American investor contemplating foreign investment.

Regardless of the bright legal and economic protection situation, the warning must be reiterated that a U.S. corporation should look very closely at the total economy of the host country and its monetary relations with the rest of the world. If the balance of payments situation becomes extremely critical, the IMF and all treaties based on its existence may become relics of the past.

One thing is certain: the full convertibility envisioned by the IMF and a worldwide system void of exchange controls are not viable prospects for the near future.

Patrick J. Broderick

⁸⁹ A discount of up to 5% was formerly considered tolerable in order to allow for minor fluctuations and such ordinary expenses as transfer commissions, mail or cable transfer charges, transaction stamp taxes and other normal costs for the machinery of transferring local currency into dollars. *INTERNATIONAL BUSINESS TRANSACTIONS* 340 n.132.

⁹⁰ *OVERSEAS PRIVATE INVESTMENT CORPORATION* 8.

⁹¹ *INTRODUCTION TO OPIC* 3.

*Appendix I**

Members which have accepted the obligations of Article VIII, Sections 2, 3 and 4 of the IMF Articles of Agreement:

Argentina	Ecuador	Italy	Norway
Austria	El Salvador	Jamaica	Panama
Australia	France	Japan	Peru
Belgium	Germany, Fed. Rep.	Kuwait	Saudi Arabia
Bolivia	Guatemala	Luxembourg	Singapore
Canada	Guyana	Malaysia	Sweden
Costa Rica	Haiti	Mexico	United Kingdom
Denmark	Honduras	Netherlands	United States
Dominican Republic	Ireland	Nicaragua	

*J. Gold, *The Funds Concepts of Convertibility*, Appendix (1971) verified by International Monetary Fund, Office of Information, Washington, D.C., June 28, 1973.

Appendix II

Countries which have treaties with the United States regarding the application of exchange restrictions signed since the creation of the IMF:

<i>Country</i>	<i>Effective Date</i>	<i>Citation</i>
Belgium	10/3/63	(1963) 14 U.S.T. 1284
Denmark	7/30/61	(1961) 12 U.S.T. 908
Ethiopia (a)	10/8/53	(1953) 4 U.S.T. 2134
France (b)	12/31/60	(1960) 11 U.S.T. 2398
Germany, Fed. Rep.	7/14/56	(1956) 7 U.S.T. 1839
Greece	10/13/54	(1954) 5 U.S.T. 1829
Iran (c)	6/16/57	(1957) 8 U.S.T. 899
Ireland	9/14/50	(1950) 1 U.S.T. 785
Israel	4/3/54	(1954) 5 U.S.T. 55
Italy (d)	3/2/61	(1961) 12 U.S.T. 131
Japan	10/30/53	(1953) 4 U.S.T. 2063
Korea	11/7/57	(1957) 8 U.S.T. 2217
Luxembourg	3/28/63	(1963) 14 U.S.T. 251
The Netherlands	12/5/57	(1957) 8 U.S.T. 2043
Nicaragua	5/24/58	(1958) 9 U.S.T. 449
Oman (e)	6/11/60	(1960) 11 U.S.T. 1835
Pakistan	2/12/61	(1961) 12 U.S.T. 110
Thailand (a)	6/8/68	(1968) 19 U.S.T. 5843
Togo (a)	2/5/67	(1967) 18 U.S.T. 1
Viet Nam (a)	11/30/61	(1961) 12 U.S.T. 1703

All agreements are Treaties of Friendship, Commerce, and Navigation unless otherwise noted:

- (a) Treaties of Amity and Economic Relations
- (b) Convention of Establishment
- (c) Treaty of Amity, Economic Relations, and Consular Rights
- (d) Supplement to the Treaty of Friendship, Commerce, and Navigation of Feb. 2, 1948. 63 Stat. 2255, T.I.A.S. No. 1965.
- (e) Treaty of Amity, Economic Relations, and Consular Rights.