OWNERSHIP AND CONTROL OF FOREIGN DIRECT INVESTMENT:
INDIA AND CANADA

BY
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We accept this thesis as conforming
to the required standard

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ABSTRACT

The aim of this thesis is to examine issues pertaining to ownership and control of foreign direct investment in two countries, India and Canada. The first is a developing country with a broad industrial base. The second is a developed country which is still essentially resource-exporting inspite of its sophisticated technology and industry. A plea has been made for international regulation of foreign direct investment in order to make it a truly effective tool of economic growth and development.

The costs and benefits of foreign direct investment have been examined in Chapter 1 with special emphasis on developing countries. Attempts have been made in various international forums to develop a mechanism to regulate foreign direct investment. UN has made the most comprehensive effort with the appointment of the Group of Eminent Persons in 1972. Their recommendations and the accompanying comments have been discussed to highlight the divergence of views between developing and developed countries.

The impact of colonization on developing countries with its consequent problems like formation of resource-based economies has been discussed in Chapter II. Canada being a largely resource-exporting economy inextricably
linked with USA has several parallels with developing countries.

In Chapter 3 I have discussed the historical background of foreign direct investment in India and its perceived costs. Provisions of Foreign Exchange Regulation Act, 1973 have been examined to assess India's attempts to regulate foreign direct investment.

Chapter 4 has dealt with the role of foreign direct investment in Canadian economy and its perceived costs and benefits. Foreign Investment Review Act, 1973 and Investment Canada Act, 1985 have been analysed to understand Canada's attempts at regulation of foreign direct investment.

The Draft Code of Conduct produced by the UN Commission on Transnational Corporations has been discussed in Chapter 5. Areas of international agreement and disagreement have been classified and possible solutions seen to make this a universally acceptable code.

I have concluded that it would be beneficial to adopt a universally acceptable international code of conduct. This can eventually acquire the force of customary international law and provide guidelines for national legislation to make foreign direct investment an effective tool in economic development.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Abstract</th>
<th>ii</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>i</td>
</tr>
<tr>
<td>Chapter I: Costs and Benefits of Foreign Direct Investment</td>
<td></td>
</tr>
<tr>
<td>(i) Introduction</td>
<td>11</td>
</tr>
<tr>
<td>(ii) Portfolio and Direct Investment</td>
<td>12</td>
</tr>
<tr>
<td>Costs of Foreign Direct Investment</td>
<td>15</td>
</tr>
<tr>
<td>(i) Exploitation of Natural Resources</td>
<td>15</td>
</tr>
<tr>
<td>(ii) Employment</td>
<td>15</td>
</tr>
<tr>
<td>(iii) Labour</td>
<td>17</td>
</tr>
<tr>
<td>(iv) Technology</td>
<td>18</td>
</tr>
<tr>
<td>(v) Research and Development</td>
<td>20</td>
</tr>
<tr>
<td>(vi) Inappropriate Products</td>
<td>20</td>
</tr>
<tr>
<td>(vii) Extraterritoriality</td>
<td>20</td>
</tr>
<tr>
<td>(viii) Intra-Company Transactions</td>
<td>22</td>
</tr>
<tr>
<td>(ix) Administrative Control of the Enterprise</td>
<td>23</td>
</tr>
<tr>
<td>(x) Disclosure of Financial Information</td>
<td>24</td>
</tr>
<tr>
<td>(xi) Transfer Pricing</td>
<td>25</td>
</tr>
<tr>
<td>(xii) Effect on Capital Flow</td>
<td>26</td>
</tr>
<tr>
<td>(xiii) Consumer Protection</td>
<td>28</td>
</tr>
<tr>
<td>Rise of Nationalism</td>
<td>29</td>
</tr>
<tr>
<td>International Regulation of Transnationals - U.N.</td>
<td>29</td>
</tr>
<tr>
<td>Areas of Agreement of Agreement in the Recommendations</td>
<td>31</td>
</tr>
<tr>
<td>(i) National Treatment</td>
<td>31</td>
</tr>
<tr>
<td>(ii) Non-interference in internal affairs of host country</td>
<td>31</td>
</tr>
<tr>
<td>(iii) Labour Standards</td>
<td>32</td>
</tr>
<tr>
<td>(iv) Consumer Protection</td>
<td>33</td>
</tr>
<tr>
<td>(v) Tax Treaties</td>
<td>33</td>
</tr>
<tr>
<td>Disagreements</td>
<td>34</td>
</tr>
<tr>
<td>(i) Guidelines for Multinationals</td>
<td>34</td>
</tr>
<tr>
<td>(ii) Ownership and Control</td>
<td>35</td>
</tr>
<tr>
<td>(iii) Dispute Situations</td>
<td>38</td>
</tr>
<tr>
<td>(iv) Technology</td>
<td>39</td>
</tr>
<tr>
<td>(v) Competition, Conflicts and Intra-Corporate Affairs</td>
<td>41</td>
</tr>
<tr>
<td>(vi) Screening Process</td>
<td>43</td>
</tr>
<tr>
<td>(vii) Other Areas of Disagreement</td>
<td>45</td>
</tr>
<tr>
<td>Evaluation</td>
<td>46</td>
</tr>
<tr>
<td>Conclusion</td>
<td>52</td>
</tr>
</tbody>
</table>
Chapter II: Foreign Direct Investment in Perspective

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>54</td>
</tr>
<tr>
<td>What is Development</td>
<td>55</td>
</tr>
<tr>
<td>Differences Between Developed and Developing Countries</td>
<td>57</td>
</tr>
<tr>
<td>(i) Colonization and Time of Industrialization</td>
<td>57</td>
</tr>
<tr>
<td>(ii) Population</td>
<td>60</td>
</tr>
<tr>
<td>(iii) Technology</td>
<td>61</td>
</tr>
<tr>
<td>(iv) Psychology</td>
<td>63</td>
</tr>
<tr>
<td>Problems Faced by Developing Countries</td>
<td>64</td>
</tr>
<tr>
<td>Special Features of Canada</td>
<td>67</td>
</tr>
<tr>
<td>(i) Canada, a resource-based country</td>
<td>67</td>
</tr>
<tr>
<td>(ii) Influence of USA</td>
<td>71</td>
</tr>
<tr>
<td>Conclusion</td>
<td>77</td>
</tr>
</tbody>
</table>

Chapter III: India and Foreign Investment

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical Background</td>
<td>79</td>
</tr>
<tr>
<td>1949 Policy Statement on Foreign Direct Investment in India</td>
<td>86</td>
</tr>
<tr>
<td>Costs and Benefits of Foreign Investment as Perceived in India</td>
<td>90</td>
</tr>
<tr>
<td>(i) Technology</td>
<td>91</td>
</tr>
<tr>
<td>(ii) Duplication of Technology</td>
<td>94</td>
</tr>
<tr>
<td>(iii) Efforts to Augment Capital</td>
<td>95</td>
</tr>
<tr>
<td>(iv) Monetary Costs</td>
<td>96</td>
</tr>
<tr>
<td>(v) Unemployment</td>
<td>98</td>
</tr>
<tr>
<td>(vi) Under and Over-Invoicing</td>
<td>99</td>
</tr>
<tr>
<td>Foreign Exchange Regulation Act, 1973</td>
<td>100</td>
</tr>
<tr>
<td>(i) Salient Features of Section 29</td>
<td>101</td>
</tr>
<tr>
<td>Guidelines for Administering S.29 of FERA</td>
<td>104</td>
</tr>
<tr>
<td>(i) Scope</td>
<td>104</td>
</tr>
<tr>
<td>(ii) Companies with more than Forty Percent Shareholding</td>
<td>105</td>
</tr>
<tr>
<td>(iii) Trading Activities</td>
<td>107</td>
</tr>
<tr>
<td>(iv) Other Activities</td>
<td>109</td>
</tr>
<tr>
<td>Oil Exporting Developing Countries</td>
<td>110</td>
</tr>
</tbody>
</table>
## Table of Contents

**Non-Resident Indians and Persons of Indian Origin**
- Direct Investment 112
- Portfolio Investment 113
- Free Trade Zones 114
- Impact of S.29 115

**Legal Implications of S.29 and Pivotal Role of Reserve Bank of India**
- Dilution of Equity Holding 121
- Reasonable Opportunity to Make a Representation 126
- Permission of Reserve Bank of India 128

**Conclusions** 131

**Chapter IV: Canada and Foreign Investment**
- Factors Shaping Canada’s Investment Policy 137
- Development of Economy in Canada 138
- Benefits and Costs 140
- Predecessors of FIRA 144
- Foreign Investment Review Act, 1973-74 147
- Difficulties Caused by FIRA 149

- Negotiating Process 149
- Extra-territorial Implications of FIRA 151
- Significant Benefit Criterion 153
- Reviewable Investments 154
- Delays 154
- Third-Party Representations 156
- Unwieldiness of the Process 156
- Confidentiality 157
- Compliance with the Act 157
- Other Problems 158

**FIRA to Investment Canada** 158

**Report of the Macdonald Commission** 162

**The Other Macdonald Report** 172

**Investment Canada and FIRA** 173

- Purpose 173
- Responsibilities of the Minister 174
- Significant Benefit 175
(iv) Who can Invent 176
(v) Acquisition of Control 178
(vi) New Business 180
(vii) The Review Process 181

Conclusions 184

Chapter V: Towards An International Code of Conduct

Introduction 188
Need for a Universally accepted code 188
Steps Towards Formulation of the code 192
Areas of International Agreement 194
(i) Co-operation with Host States 194
(ii) Intergovernmental Co-operation 195
(iii) Ownership and Control 196
(iv) Export Objectives 197
(v) Consumer Protection 198
(vi) Disclosure of Information 199
(vii) Conflict of Jurisdiction 199
(viii) Implementation of the Code 200

Outstanding Issues 202
Preambles and Objectives 202
(i) Definition and Scope 203
(ii) Non-collaboration with racist regimes in Southern Africa 206
(iii) Nationalization 207
(iv) National Treatment 211
(v) Dispute Settlement 213
(vi) Non-interference in internal affairs 215

Basis for Concluding Document 215

Conclusion 219

Conclusion 223

Notes 228

Annexures 270

Select Reading 276
# LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Estimated foreign-controlled shares of output and employment in manufacturing, Argentina, 1955-1972</td>
<td>16</td>
</tr>
<tr>
<td>2</td>
<td>Degree of Industrialization and Finished Manufactures as a Proportion of Trade: 1913, 1929, 1955 and 1980.</td>
<td>68</td>
</tr>
<tr>
<td>3</td>
<td>Total (cumulative) Investment in Canada</td>
<td>75</td>
</tr>
<tr>
<td>4</td>
<td>Foreign Companies in India</td>
<td>132</td>
</tr>
</tbody>
</table>
INTRODUCTION

Economic interdependence is an indisputable part of modern world economy. Developing countries need foreign investment and technology for rapid economic growth and development. For the developed countries too, as the Brandt Commission report points out, it is not a question of "enlightened charity."\(^1\) It is necessary for their own continued economic growth that the developing countries improve their purchasing power through industrialisation in order to provide markets for the valuable imports from the developed countries and be able to repay their loans thus maintaining stable economic conditions in the world.

Foreign direct investment has been recognized as an important tool for economic growth and development. Transnational corporations with their capacity to move capital, technology and entrepreneurship are the chief means of foreign direct investment. There is no agreement in various international forums about the precise legal definition and scope of transnational corporations.\(^2\) Broadly speaking, an enterprise becomes transnational when it makes an investment in another country while it is incorporated in one country and includes entities like joint ventures, co-opera-
tives and State-owned activities. The decision to invest abroad is taken because of superior business alternatives presented elsewhere which would result in an increase of profits and in the expansion and growth of the enterprise. Hence, it is not per se geared to economic growth and development of that place and may lead to a conflict of interest between the host country and the enterprise.

The "package" of product, technology, management, capital and market access brought by transnationals can lead to several economic benefits for the host country, like improvement in balance of payment position because of increase in exports combined with reduction in imports due to import substitution; augmentation of capital resources, creation of jobs; access to latest technology and markets; improvement in managerial skills; a boost to the growth of domestic enterprise; and plentiful availability of consumer goods leading to better standards of living. On the other hand, it can bring with it certain costs. Easy access to markets does not necessarily mean the best price. The technology used may not be appropriate for the host country and consumer goods quite unsuitable for that economy may be introduced. The very ease with which technology and managerial skills can be imported may be a disincentive for the development of indigenous know-how. Hence,
while there is an indisputable need for foreign direct investment, there is also a need to regulate it so that it can be geared to economic growth and development.

Although different countries attach different degrees of importance to the costs and benefits of foreign direct investment, certain perceptions are common to developing countries and others to developed countries as a whole, mainly because the majority of developing countries have been former colonies and have thus missed the industrial revolution. They are now trying to industrialize long after the developed countries and the loss of time has had serious consequences. They have been left far behind in acquiring technical knowledge, the technology available is adapted to the needs of industrialized nations because all the research and development has taken place there; they are faced with population explosion because of improved health standards; and they have neither the time nor the resources and skill to catch up with the industrialized nations without help.

Foreign direct investment can be an important means of acquiring capital, technology and managerial and entrepreneurial skills, but, as the Brandt Commission Report recognizes, the industrialized nations with over ninety per cent of the world's manufacturing industry from where
foreign direct investment originates have immense economic power and technical superiority and they are often reluctant to surrender control over economic decisions. The developing countries, while they want to benefit from foreign direct investment, do not want to lose control over their economies especially in the light of the past colonial experience and want to be able to treat on fair terms and with equal expertise with transnational corporations. Hence, a potential conflict situation develops which the developing countries try to resolve through national legislation for regulating foreign direct investment.

India and Canada have been taken as examples of a developing and a developed country respectively and their efforts to maximize the benefits and at the same time, to minimise the costs by regulation of the ownership and control of foreign direct investment through national legislation have been examined. Canada and Australia are the only two developed nations which have a formal screening agency for foreign direct investment. As was stated by the Honourable Mark MacGuigan, Secretary of State for External Affairs, in an address to the Society for International Development, Canada is "at once industrialized and resource-based, sophisticated, yet in some ways under-developed." It, therefore, shares "many of the perspectives" of the industrialized nations and its "position as a major exporter of raw materials
and net importer of capital and technology is similar to the situation of many developing countries. Canada has been characterized both as the world's smallest industrialized country and as its largest developing country."⁵

Since Canada with its unique position can appreciate both points of view, it has consistently tried to "conciliate the conflicting views of industrialized and developing countries."⁶

India, a country with a colonial past, started industrialization only after independence in 1947. It has developed a broad industrial base by a judicious use of foreign investment chiefly as an instrument of transfer of technology while it has attempted to retain ownership and control over it mainly through equity ownership. Ordinarily, not more than 40% of equity holding is allowed to foreigners though where a certain technology has been considered important for the country, higher percentage of foreign equity holding even upto 74% has been allowed. Pragmatic policies have been evolved for the purpose of augmenting foreign exchange resources. Export-oriented industries can be allowed even upto 100% foreign equity holding. Besides, investment schemes have been formulated for non-resident Indians and for oil exporting developing countries who have the capital but not necessarily the technology. Hence, India has tried
to guide foreign investment in a way that it can provide maximum benefits while it has attempted to retain control with a fair measure of success. Of course, the investment scheme is not perfect and collusion can take place between the local partner and the transnational resulting in economic costs to the country. Besides, the growth could possibly have been faster if multinationals had been allowed free entry, but it is also a question of developing indigenous industry to ensure economic independence, cultural identity and a strong base for future growth.

The Canadian experience demonstrates how economic development and rapid industrialization leading to high standards of living can take place with the help of foreign investment. Capital for infrastructure like the St. Lawrence Canal System and the construction of railways took place with the help of portfolio investment mainly from Great Britain. Direct investment from USA took place in both natural resources and in manufacturing till gradually USA became the main investor in Canada and also Canada's main trading partner.

Although foreign investment has brought obvious benefits to Canada, concern has also been expressed about the costs of this investment like irrevocable depletion of natural resources; truncation of industries leading to
a branch plant economy; replication of technology of the
parent plant resulting in lesser research and development
in Canada; import and export restrictions imposed by the
parent company on its subsidiaries; and the extra-terri-
torial extension of US laws in Canada. Further, Canada
being a resource-based country and having an economic power
like the US as its neighbour, has also felt concerned about
its independent cultural identity.

Canada has not been so concerned about the aggregate
amount of foreign investment as with the large measure of
resulting non-resident control and that, too, of largely
one country, the US, over some of its most important indus-
tries and industrial activities. This is not to suggest
that such a control has been or is likely to be used to
the detriment of Canada, but there is a consciousness that
companies controlled by non-residents may not always be
aware of the Canadian point of view and may not be adequately
sensitive and responsive to Canadian economic aspirations.
The effort has been to maximize the benefits of US invest-
ments in Canada by ensuring that the investment is of
"significant benefit" formerly under FIRA or of "net benefit"
now under Investment Canada to Canada and, at the same time,
to maintain an independent and separate cultural identity.
Protests over the restrictions imposed under FIRA and its
cumbersome procedures finally led to the enactment of
Investment Canada which has considerably liberalised foreign investment but has still tried to ensure that the investment is of net benefit to Canada and in accordance with Canadian policies and aspirations.

Thus we see, that though they are so different from each other, both India and Canada have tried to regulate foreign investment according to their own perceived needs. In fact, restrictions on foreign investment exist in every country whether overtly through a screening agency, or more diffusely in different statutes.

Therefore, economic interdependence is an inescapable fact; the developing countries cannot be ignored without causing economic instability; and foreign direct investment can, if judiciously used, be a powerful tool for economic development. As the situation is today, the "home countries are concerned with the undesirable effects that foreign investments by transnationals may have on domestic employment and on balance of payments. Most countries are worried about issues of ownership and control of key economic sectors by foreign enterprises, the extent of their encroachment on their political sovereignty and their possible adverse influence on socio-cultural values. Labour interests are concerned about the impact of multinational enterprises on employment and workers' welfare and on the bargaining
strength of trade unions. Consumer interests are concerned about the appropriateness, quality and price of the goods produced by the multinational corporations. The multinational corporations themselves are concerned about the possible nationalization or expropriation of their assets without adequate compensation and about restrictive, unclear and frequently changing government policies.  

Therefore, the need for a universally acceptable international code is obvious by which the interests of all the parties can be safeguarded. That this need has been felt is apparent from the efforts made in several international forums including the UN to formulate such a code.

The OECD Guidelines for Multinational Enterprises, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, the Draft Code of Conduct on the Transfer of Technology and the International Code of Marketing of Breast-Milk Substitutes are some of the important instruments that have resulted. All of these are, however, inadequate because they are limited in scope. The only effort to formulate a universally acceptable code of conduct has been made by the UN through the Commission on Transnational Corporations meeting annually
since 1975, and a major part of it has been agreed upon. Disagreement still persists on certain vital issues dealing with nationalization and compensation and on the definition and scope of transnational corporations. There is also a difference of opinion on whether the code should be voluntary or mandatory. There are three possibilities: to abandon the efforts; to wait till there is agreement on all the remaining issues, or to adopt the code as it is. A lot of ground remains to be covered and genuine political commitment will be required before any universally acceptable solution can be found.
CHAPTER I

COSTS AND BENEFITS OF FOREIGN DIRECT INVESTMENT

Introduction

In the period after the Second World War a dramatic increase in the number of independent, sovereign, political States with their own economic aspirations took place as a result of decolonization. With this the international system became more complicated, but also more interdependent. Increasingly, it has been found necessary to find multilateral solutions and in this context the importance of co-ordination of economic activity among nations cannot be overlooked. This period has also witnessed an increase in the prominence of foreign direct investment primarily through transnational corporations. These corporations, with their ability to move capital, technological and human resources round the world, and with their ability to transfer this movement into economically useful and commercially profitable activities, have become important actors on the stage of world economy. The transnational character of their activities has emphasized the economic interdependence among nations.
Portfolio and Direct Investment

Foreign investment can take place either as portfolio investment or as direct investment. The two have different implications. Portfolio investment results in the pure flow of savings from a foreign country. Domestic business or governments decide that some project, example, expansion of a business or the undertaking of a development project, is necessary. In order to finance the undertaking, debt instruments are sold to foreigners. These debt instruments may be in the form of bonds, debentures or non-voting shares. Usually, the debtor pays an yearly interest to the purchaser of the security and the purchaser is presumed to have purchased the security because it yielded more than any other security. Debt instruments such as these are usually for a fixed term. Therefore, in this case the decision with regard to investment lies with the country raising the capital. Hence, in portfolio investment the investor does not acquire control of the assets of the issuing corporation.

Direct investment takes place as a result of a decision made in a foreign country. Foreign business decides that a particular country presents superior business alternatives and, therefore, locates its business in that country to exploit those opportunities. Since it is foreigners who initiate the capital flow, they also control the real
capital formation financed by that inflow. Share ownership maintains the control. The most common form of foreign direct investment is a subsidiary corporation incorporated in the host country, but controlled by its parent in the home country. Legally, ownership of 51% of the shares would be required to control the enterprise, but it is well-established that a far smaller percentage of shareholding can result in control. The degree of control by the parent corporation may vary but even where the subsidiary enjoys a large degree of autonomy, the head office has to be consulted at least on major policy changes.

Increasingly, foreign direct investment is taking the form of joint ventures as many host countries, especially the developing countries, are now insisting that some of the new business's equity be held by indigenous businessmen. Co-operatives and State-owned enterprises have also been included under the broad framework of foreign direct investment.

While foreign portfolio investment is essentially a movement of capital, foreign direct investment made by transnational corporations results not only in movement of capital but also in that of technology, and managerial and entrepreneurial skills. Moreover, it provides access to new markets. Hence, it is a powerful instrument of change
and can be used for economic growth and development. But since foreign direct investment, unlike portfolio investment, shifts the focus of control outside the country, it becomes not only an economic but also a political phenomenon. While host countries are concerned with economic development and growth in their own countries, the goals of transnationals like all business enterprises, are profit and growth. The difference in objective suggests that their respective decisions may not always be in harmony.

Thus, foreign direct investment may be perceived as bringing costs together with benefits for the host country. The developing countries with their weak economies want the benefits of foreign direct investment, but try to minimize the costs through national legislation. The costs of foreign direct investment have been discussed with special reference to developing countries. Some of these concerns have also been a matter of debate in Canada which, being chiefly a resource-exporting country and a neighbour to a powerful economy like USA, shares some concerns in common with developing countries. This is also evident from the fact that Canada unlike most other developed countries, has found it necessary to establish a screening agency for foreign direct investment.
Costs of Foreign Direct Investment

Exploitation of Natural Resources

The earliest motivation to invest abroad was the desire to develop and control the sources of raw materials. In the second half of the nineteenth century, Europeans and North American businessmen laid the foundations of many of today's major transnational corporations concerned primarily with the extraction, transportation and processing of raw materials. The host countries would naturally want to secure fair prices for the commodities sold and would also want as much of the processing of raw materials as possible to take place in their countries. This may not be the objective of the transnational corporations following a global strategy.

Employment

Transnational corporations often concentrate on high technology industries with capital-intensive techniques. Such industries may lead to the eventual modernization of the industrial structure of the host country but may not serve one of the immediate prime requirements, namely, to increase employment opportunities because the increase may be marginal in relation to the massive employment problem. As has been pointed out in Multinational Corporations in World Development,¹ this problem arises particularly in relation to foreign affiliates participating in extractive
industries which, when operated on a large scale, are highly capital-intensive. In Venezuela and Chile, for example, despite the importance of oil and copper, labour employed in the combined petroleum and mining sectors was only 2.3% and 4.1% respectively of the total economically active population in 1960. The following table in Transnational Corporations in World Development: A Re-examination, shows that while the estimated percentage of output in Argentina in manufacturing has gone up from 18% of total output in 1955 to 31% in 1972, the estimated percentage of employment remains constant at 11%.

Table I
Estimated foreign-controlled shares of output and employment in manufacturing, Argentina, 1955-1972

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimated percentage of output</th>
<th>Estimated percentage of employment</th>
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<tr>
<td>1955</td>
<td>18</td>
<td>11</td>
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<tr>
<td>1960</td>
<td>21</td>
<td>12</td>
</tr>
<tr>
<td>1965</td>
<td>26</td>
<td>11</td>
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<tr>
<td>1970</td>
<td>27</td>
<td>11</td>
</tr>
<tr>
<td>1972</td>
<td>31</td>
<td>11</td>
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Also, according to International Labour Organization, the total number of people employed by transnationals in 1976 is approximately 13 to 14 million, with about 2 million being employed in developing countries. However, 26% of the total stock of foreign direct investment was in developing countries. From this it follows that about 26% of total employment should also have been in developing countries. But this is not the case as is evident from the above figures.

While these enterprises may not generate large-scale employment on a national scale, however, they do generate employment in specific localities which is a major attraction. This is especially true of depressed areas where the location of a plant can make a significant contribution to solving local unemployment problems. Some countries have tried to solve this problem by raising percentage of local employment by using precise employment programmes or schedules requiring certain employment levels to be reached within certain time periods. These requirements have been written into initial agreements with transnational corporations.

Labour

The relatively high labour standards generally adopted by foreign affiliates prove to be a mixed blessing.
In some cases, the wage rates paid by the transnationals are several times higher than the prevalent local wage rates in the host countries leading to the creation of elite labour groups. Technical personnel prefer the foreign enterprise over the local one. Further, it accentuates wage disparities between skilled and unskilled labour. The higher wages also gradually tend to be adopted as the national norm although they may be beyond the means of less-developed host countries.

**Technology**

A problem with the importation of high technology is that it may not necessarily be suitable for a less developed country. Not only that, the host country may have to pay a very high price for the technology so acquired.

Developed countries serve as both home and host countries, so the impact of foreign technology for them is not as great because technology flows and payments move in both directions. For developing countries, on the other hand, the flow is predominantly or exclusively in one direction. The significance of this one-sided flow is illustrated by data on six developing countries -- Argentina, Brazil, Colombia, Mexico, Nigeria and Sri Lanka -- in the 1960's. Payments made by these countries for patents, licences,
know-how and trademarks amounted to approximately 7% of management and service fees of their combined exports and to a little more than half of 1% of their combined gross domestic product. The total cost for such payments for thirteen developing countries which accounted for 65% of the total population and 56% of the total gross domestic product of developing countries was estimated at more than half of the flow of direct private foreign investment to developing countries. 4

Transnational Corporations in World Development: A Re-examination indicates measures taken by several countries to ensure as far as possible favourable contractual provisions for the licences. 5 The Foreign Investment Board in India, for example, exercises second-check functions. In some countries official approval is required for licensing agreements. Countries like Mexico have prescribed 3% of net sales as a ceiling limit for royalty payments. The limit is arbitrary but it ensures that unduly high royalty payments are not made. The question of technology payments is closely linked to the duration of agreements. A number of countries have prescribed maximum duration periods. In India, usually a five-year limit is imposed. Many Latin American countries impose a maximum limit of 10 years. Thus, an effort has been made to reduce the cost of technology being acquired.
Research and Development

Foreign affiliates do not carry out all the functions -- from the original research required through to all the aspects of marketing -- necessary for developing, producing and marketing their goods. One or more of these functions are carried out by the foreign parent. Thus, research and development, components and services, especially the more sophisticated aspects, may be carried out by the foreign parent. This may lead to "truncation" of the foreign affiliate. These practices may be rational from the point of view of the global strategy of the transnationals but the host country may see itself becoming dependent on the foreign company.

Inappropriate Products

Many of the products developed by transnationals cater to demands in high income countries. Thus, they may introduce patterns of consumption which are not conducive to sustained development and do not benefit the vast majority of population in developing countries. This is especially true of luxury articles for the few which have little impact on the economy as a whole.

Extraterritoriality

The most apparent cost for the host country of foreign ownership results from extraterritoriality --
intrusion of jurisdiction of one country into another, or
the subjection of residents of one country to the laws and
policies of another country. A direct investment subsi-
diary resident in one country and owned and controlled by
residents of another is a vehicle through which extra-
territoriality can be exercised. In theory this can run
both ways -- the host country can subject the parent of
the subsidiary to its own laws in addition to the subsci-
diary. But laws of property and also the fact that the
host country is often smaller than the country of origin,
usually results in the home country exercising extraterrri-
toriality in the host country. Hence extraterritoriality
usually works against the host country. The government
of the host country, too, sometimes feel reluctant to pur-
sue policies in respect of transnational corporations that
are desirable from its national point of view because of
its concern for repercussions, apparent or real, arising
from the reactions of the home country government. Thus
in actual terms, sovereignty, the essence of which is the
capacity to make independent legal decisions, may be eroded.

The subsidiary is in a difficult position because
it is expected to meet the standards of good corporate
behaviour in the host country but it finds it is being
subjected to overlapping or even divergent jurisdiction
-- legal constraints in the host country and legal constraints from the home country which are in conflict with each other. Confronted with two peaks of sovereignty it is likely, as is pointed out in the Watkins Report, to defer to the higher peak where its parent resides.

The position of the parent is even more ambiguous. As a corporation pursuing profit and growth, it is in its interest to allow the subsidiaries to comply with local jurisdiction if possible. However, its directors and managers are citizens of the home country subject to the laws of the home country, sharing its objectives especially in matters of defence and foreign policy, the areas in which extraterritoriality is most likely to occur.

**Intra-company Transactions**

It has been argued that all firms strive to maximize profits and that the host country should be indifferent to whether a firm is a separate national enterprise or an affiliate of transnational enterprise. This is not necessarily correct. The parent firm may expect the subsidiary to behave in a way that the global profits of the transnational are maximized rather than the profits of the subsidiary itself. The interest of the host country, however, lies in maximizing the profits of the subsidiary in its domain as it is concerned with the growth of its
own economy and not with the transnational as a whole. In some cases this may make little difference but in others it may make more. The parent may find it in its interest to limit the subsidiary in its freedom to export. It may require that the subsidiary sell only to its affiliates or the subsidiary may be required to observe the market sharing arrangements made by the parent. According to the Watkins Report, it was found that a large number of foreign affiliates in Canada were following export-restrictive policies apparently a reflection of the marketing strategies of the parent companies which try to protect export markets for themselves or for their affiliates.  

The parent may also impose restrictions on procurement. The subsidiary may be required to buy from affiliate or to import rather than buy from local sources. Where such restrictions exist, they may not be in the interest of host country. But where such restrictions do not exist or work to the advantage of the subsidiary, it may be of benefit to the host country.

Administrative Control of the Enterprise

Sources of tension may also exist in the administrative structure of the transnational firm. Corporations going abroad prefer to invest in a branch or subsidiary
rather than to go in for licensing arrangements or joint ventures with local firms. This is because they are reluctant to share the returns that result from their investment or because they do not want to dilute ownership in a way that makes it more difficult to maintain control over the subsidiary, or because they want to avoid the inconvenience of letting outsiders have a say in how the firm should be run. The host country may prefer joint ventures and licensing agreements which support domestic firms; create potential areas of growth for domestic entrepreneurs in spite of certain inefficiencies in such arrangements; permit host country to share in the returns; and ensure that the host country has a voice in the running of the firm so that their interests are not jeopardized.

Disclosure of Financial Information

When the subsidiary is not an entity fully distinct from the parent, it can create problems with respect to meaning and availability of financial information about the operations of the subsidiary. Since transactions take place between the parent and the subsidiary rather than in the open market, there may be considerable scope for arbitrary valuation of intra-firm transactions. In Canada, three-fourths of all exports of foreign affiliates were accounted for by intra-company sales in 1969. Not only
that, in Canada, three-fourths of the imports of foreign affiliates which amounted to one-third of their total purchases were from other affiliates and almost all the imports of US affiliates originated in the home country. This leaves a large scope for transfer pricing and also the host country's economy becomes vulnerable to foreign governmental or corporate policies.

Further, in such a situation, the public is denied important information and the government of the host country has to decide important policy matters without adequate statistics. Moreover, providing inadequate information to the host country can circumvent national policies rendering them ineffective. The transnational character of these enterprises enables them to move their incomes to tax havens. The situation is aggravated by developing countries engaging in competitive granting of tax concessions to transnationals and giving other incentives to attract foreign investment. These involve a measure of sacrifice on the part of developing countries because resources from poor host countries are transferred to rich home countries reducing the benefits that flow from the operations of the transnationals.

Transfer Pricing

In transactions between the parent corporation and its subsidiaries, the normal market forces do not come into
play. Hence goods and services in these transactions can be overpriced or underpriced. Often the flow of technology from a parent to its subsidiary is linked with the sale of intermediate products and capital goods from the subsidiary to the parent. In such a situation, the technology may be overpriced and the goods may be underpriced resulting in a benefit to the enterprise as a whole, but loss to the host country both in the profits that the subsidiary should have earned and in tax.

Effect on Capital Flow

Foreign investment can be seen as movement of capital between two countries. If capital is scarce at home, it can be imported. Therefore, foreign capital can add to the country's stock. Foreign investment not only provides capital but also foreign exchange to the extent that the borrowing country is short of foreign exchange. But the cost to the capital-importing country consists of future interests and dividends that it must pay abroad. The servicing of debt and its repayment or repatriation means that the capital importing country must forego consumption or investment and adjust its balance of payments to effect the transfer of funds. When these adjustments are made with difficulty because of foreign exchange constraints, foreign investment imposes an additional burden on the
capital importing country just as it provided an additional benefit of making foreign exchange available at the time of loan.

For the developing countries as a whole, direct investment amounted to $4 billion in 1971 which was almost half the total official bilateral and multilateral flows. But if the earnings generated by past investment accrued to the foreign affiliates are deducted from that flow, the net flow is generally negative for host countries. Between 1965 and 1970, net foreign direct investment inflow into 43 developing countries was 30% of the investment income outflow. If the oil-producing countries in the sample are excluded, inflow was 68% of the outflow. Another calculation adjusted for petroleum, shows that between 1964 and 1968, the US and the UK, representing 80% of total foreign direct investment, received approximately $5.8 billion from developing countries in investment income and paid $3.2 billion in capital flow.\textsuperscript{11}

A 1981 Report of the Secretariat of the Commission on Transnational Corporations also comes to the conclusion that "despite the considerable measurement problems involved, home and host country studies point to the tentative conclusion that direct investment by transnational corporations tends to have a negative direct
effect on the balance of payments of host countries and a positive one on that of home countries."\textsuperscript{12}

In developing countries where the supply of foreign exchange is often a problem, the excess of this outflow over inflow has been a familiar source of tension with the transnationals. Such tension is particularly likely to occur in cases where a transnational has operated in the host country to an extended period of time and where the outflow of investment income exceeds the inflow of new capital. The tension becomes aggravated if the transnational is dealing with a product which the host country does not consider essential. In India, for example, Coca-Cola was seen as a classic example of multinational operating in low priority but high profit area, because it displaced indigenous industry and caused an outflow of precious foreign exchange instead of inflow. The result was that Coca-Cola had to leave in 1977.\textsuperscript{13}

\textbf{Consumer Protection}

Another source of tension, especially in developing countries, is that in many cases multinationals have taken advantage of the more lenient consumer protection laws in these countries to sell potentially harmful or dangerous products which they could not sell in their own countries or in other developed countries. Several cases have been
cited by Prof. Sangal in which drugs have been sold in developing countries without adequate warnings. 14

Rise of Nationalism

Finally, the role of transnationals and their impact is also related intimately to the rise of nationalistic feelings which are particularly pronounced in host developing countries that have been under colonial rule. The mere presence of powerful foreign enterprises may serve as a reminder of past foreign domination. Besides, many host countries no longer want to play a peripheral role quite apart from the economic consequences.

International Regulation of Transnationals

Thus we have seen that the activities of the transnationals can impose costs on the economies of the host country. Yet, it is equally true that the transnationals have the ability to make the hoped for new international economic order a reality. It is, then, a question of guiding and regulating their activities to maximize the benefits and minimize the costs in a way that the interests of all concerned parties, including the transnationals, are safeguarded.

The United Nations Economic and Social Council unanimously adopted Resolution 1721(LIII) of 2nd July, 1972
to establish a Group of Eminent Persons to investigate the impact of transnational corporations in various national jurisdictions. The recommendations of the Group of Eminent Persons are important because they resulted in the establishment of the Commission on Transnational Corporations to deal with the full range of issues regarding transnational corporations and to work out a universally acceptable draft code of conduct to regulate foreign direct investment.

Other attempts have also been made to bring forward a universal convention on transnational corporations beginning with the Charter of the International Trade Organization signed at Havana in 1948. But this never came into effect. The OECD Guidelines for Multinational Enterprises are important in this context but they are restricted in scope since they only apply to member-countries. The recommendations of the Group of Eminent Persons provide a point of reference for the work of the Commission on Transnational Corporations but if they are read together with the comments of the representatives of some developed countries attached to them, there appears to be an almost unbridgeable gulf between the developing and the developed countries.
Areas of Agreement in the Recommendations

National Treatment: The members of the Group agreed that national treatment should be given to all foreign investments unless specific exceptions were made in national interest. Mr. Javits pointed out that transnationals had, in fact, played a greater role in development than had been recognized and had often been victims of unfair and arbitrary policies of host governments which had resorted to nationalisation without adequate compensation. He said that compensation should not only be fair and adequate, but also prompt. Long delayed compensation was of little value. While he agreed that some countries had serious balance of payment problems which could delay payment of compensation, but he was not very sympathetic to this problem. He stated that developed countries could hardly be expected to sanction soft long-term loans to these countries if, instead of using those loans for developing new productive capacities or infrastructure, they were going to use them for nationalising transnational corporation properties. Their limited resources of capital should make them more cautious about using them for acquiring ownership over existing assets.

Non-interference in internal affairs of host country: The Group condemned subversive political inter-
vention on the part of transnational corporations directed
towards the overthrow or substitution of a host country's
government or the fostering of internal or international
situations which would lead to such actions. The host
countries were recommended to impose strict sanctions in
case of such an eventuality and the home countries were
urged not to make these sanctions ineffective through their
investment guarantee schemes. Thus, transnationals were
not to be used by governments to further their foreign
policy goals. Both host and home countries were called
upon to ensure that multinationals did not violate the
sanctions imposed by the Security Council. There was no
problem about this recommendation.

Labour Standards: In the case of policies concern­
ing labour relations, too, there seems to have been agree­
ment. Home and host countries were asked to clarify their
employment objectives to the transnationals. In case
of workers displaced because of production decisions taken
by the transnationals, the home and host countries could
provide them with full compensation through general budge­
tary support, or through social security system or through
the establishment of social funds. An international social
fund could be created for this purpose for the use of deve­
loping countries without adequate funds. Also, workers
and their unions were to be involved in the decision-making
process of transnationals both at the local and international level. The home and host countries were also recommended to allow free entry to unionists from other countries representing national or international organisations engaged in legitimate investigations or other union missions including negotiations with the transnationals on behalf of the workers. Transnationals were required to adopt all the safeguards and to provide the special working conditions followed by them in their home countries adapted to the needs in host countries to ensure the health and safety of workers.

**Consumer Protection:** There was no controversy on measures regarding consumer protection. Transnationals should reveal to the host countries any sales prohibitions and restrictions in manufacturing imposed by home or by other host countries to protect the health and safety of the consumers.²⁰ It was for the host countries to decide whether similar warnings or restrictions should be imposed on the sale and manufacture of those products in their countries. Similarly, prohibitions and restrictions on products or their ingredients to be imported into host countries by transnationals should be made known to them.

**Tax Treaties:** Finally, there seems to have been little disagreement on the recommendation that developed
countries should enter into bilateral tax treaties with developing countries and that the work of the Group of Experts on Tax Treaties should be speeded up to prepare the way for an international tax agreement. 21

**Disagreements**

There were other recommendations of the Group with which the representatives of developed countries like the United States, Switzerland and Japan definitely disagreed. Mr. Ryutaro Komiya 22 of Japan, however, did not take the extreme position adopted by Mr. Jacob Javits 23 and Mr. Irwin Miller of USA 24 and Mr. Hans Schaffner 25 of Switzerland. Although the Group arrived at these recommendations through consensus, the comments, especially those of Mr. Miller and of Mr. Javits emphasize the high degree of divergence in the points of view of developing and of developed countries.

**Guidelines for Multinationals**

The Group recommended that host developing countries should specify as precisely as possible what the transnationals were expected to achieve and the conditions under which they were to operate. 26 They should also indicate the ways in which they would like the transnationals to integrate into the local economy and fit into the overall
priorities of the country. To ensure maximum benefit to the host countries, the Group recommended that the host countries must define the areas in which they were ready to accept foreign investment and conditions upon which this investment would be allowed. The Group felt that generally developing countries should be encouraged to retain ownership of their natural resources and also to control the use of them.

Mr. Javits disagreed with these recommendations because he found them impractical and even counter-productive. The only thing that the government of the host country, in his opinion, could do was to establish general guidelines for the more detailed aspects of transnationals operations. In any case, he felt, that governments did not always know best or act in the best interests of their citizens.

Ownership and Control

Most countries often sought to control the enterprise through local ownership, of equity, but majority ownership was not really essential for control. Control could be exercised by a minority where the majority of the shares were held by investors who had no common purpose and were not interested in exercising control; or if the views of
the minority and of the majority were similar. However, host countries could want a majority shareholding not only to strengthen their influence over the policies of the affiliate, but also to secure a larger share of the profits of the corporation.\textsuperscript{29}

The Group felt that where the host country saw ownership as an important objective, consideration should be given to the setting up of joint ventures. Alternatively, host countries could make provision for the review of the terms of agreement on the request of either side after suitable intervals. Not only that, provisions could be included in the initial agreements permitting the possibility of reduction over time of the percentage of foreign ownership. But it was important that such provisions be included in the agreement at the very beginning in order to avoid future conflicts.\textsuperscript{30}

Mr. Javits contended that inclusion of such provisions would discourage many investments particularly in high technology areas. It could also encourage transnationals to try to amortize all their investments during the early years of the investment resulting in higher prices and more wasteful development of resources.\textsuperscript{31}
Mr. Schaffner of Switzerland was apprehensive about the feasibility of joint ventures in many sectors because he felt that the success of a joint venture depended largely on whether the local partner could make any valid contribution or not. In certain sophisticated technology industries, he could not because they required a continuous flow of technical assistance and innovative services. Therefore, in such fields joint ventures were uneconomical and uncompetitive. Also, there was evidence that joint ventures had to pay larger royalties and fees for know-how and management than the wholly owned subsidiaries.

Further, in many cases, a transnational did not want to open the equity of its affiliate because it did not want any interference in its management. Moreover, a new investment usually did not have substantial profits in the initial years of its existence. The parent company as the stockholder could accept this because it was interested in the long-term prospects of its affiliate. The individual non-industrial stockholder on the other hand, would want immediate returns. Again, when profits were finally realized, the parent company might want to reinvest them while the local stockholders might prefer a steady flow of dividends.
In fact, Mr. Schaffner felt that the parent company would like to keep all policy matters like quality standards, promotional principles, royalties, transfer prices and others in the hands of its own management.

Dispute Situations

In case of disputes between the transnational and the host countries, the Group recommended that home countries should refrain from getting involved in them. If serious damage to their nationals was likely, the home countries should confine themselves to normal diplomatic representations and not use international agencies to exert pressure on the host countries. The host countries on their part must ensure that whenever assets of a transnational corporation were nationalized, fair and adequate compensation was given according to the due process of the law of their countries or in accordance with any arbitration agreement between the parties.

This recommendation was not acceptable to either the American representatives or to Mr. Hans Schaffner, or to Mr. Komiya of Japan. Both Mr. Javits and Mr. Komiya found it entirely proper for the home country to review its aid programmes in the case of a country that has unfairly expropriated the property of home country
nationals. But Mr. Javits conceded that such a step should only be taken when all other means had failed.

Technology

The Group recommended that before a transnational was permitted to introduce a particular product in the domestic market, the host government should evaluate its suitability for local needs. Not only that, the host countries should insist on transnationals making a reasonable contribution towards product and process innovation so that they could serve the national or regional needs. Therefore, they should encourage their affiliates to undertake the necessary research. The technology so developed should be exported to others at appropriate prices. International organizations should also evolve an overall regime under which the cost of technology provided by transnational corporations to developing countries could be reduced.

The Group recommended the establishment of a world patents or technology bank to which any public institution could donate patents which it owned or purchased for the purpose for use in developing countries. Finally, the Group suggested that transnationals were not the only way of importing technology. The developing countries could explore alternative means of acquiring suitable technology.
Once again, the difference in the positions of developing and developed countries came sharply into focus when Mr. Schaffner, echoing Mr. Miller, left no room for discussion by commenting that if developing countries preferred alternative ways of acquiring technology, the transnationals would be happy to step back and concentrate on investments in industrialized countries where the market potential tended to be higher and where the risks were much lower.\(^{36}\) A possible compromise between these two extreme positions was offered by Mr. Komiya by suggesting that lowering the price of technology for developing countries should not be a major point of debate.\(^{37}\) What was more important was that developing countries should get superior technology, the kind most appropriate for their needs and one which benefited them most. If the technology was beneficial even buying it at a higher price was to the advantage of the buyer. Buying cheap but inappropriate technology would be just a waste of money. Japan, he pointed out, had imported a great deal of technology and had paid large sums of royalty. Not only that, 70% of all contracts for the import of technology had been accompanied by some territorial restrictions. Yet, the benefits derived from this technology had been far greater than the large royalties paid for.
Competition, Conflicts and Intra-Corporate Affairs

The Group recommended that host countries should ask transnationals to declare their import and export policies and to make clear the extent, duration and justification of any possible restrictions. The Group also felt that host and home governments, through international agreements, should prohibit the market allocation of exports by transnational corporations unless such allocations were essential for other benefits to the countries concerned. The Group recommended countries of a region to group together to be in a better bargaining position with the transnationals. Restrictive clauses and market allocations were a serious hindrance to the full flow of goods and to industrial restructuring in that area. Hence, there should be no such clauses at least within the regional groups of countries. 38

Restrictive clauses were included by transnationals not only as part of their global marketing strategy but also because of different anti-trust provisions in different countries. In order to rationalize conflicting laws, the Group felt it was necessary to adopt an international anti-trust agreement. Till such time as an international agreement could be worked out, the home countries should show restraint in applying their anti-trust policies if
other governments were affected and unilateral action should only be taken on a provisional basis pending consultations with the concerned governments.

Further, a large number of transactions took place within the transnationals between the affiliates or between the parent and the subsidiaries which had potential for price distortions. Varying degrees of ownership in the subsidiaries could induce the parent company to make profits appear where its ownership was relatively large. Or affiliates might show a reduction in profits for wage bargaining. Transfer pricing may also be a way of allocating markets if the prices charged to an affiliate made its exports non-competitive. In order to avoid such distortions, the Group recommended that host and home countries should enforce "arm's length" pricing where appropriate. 34

The Group recommended international standards of disclosure, accounting and reporting which would in itself be a hindrance to manipulations within the transnationals. Also, the Group felt, that the principal terms of agreements between host governments and transnational corporations should be disclosed and deposited with the proposed centre for information and research on transnational corporations which could prepare digests and summaries of such
information and make them available to countries to facilitate their working out terms of agreement with transnationals.40

Mr. Schaffner, disagreed with these recommendations because he felt that the disclosure of information desired would normally be within the company's private sphere and not meant for public exhibition.41 Again, there were transnational corporations with tens of thousands of commodities which were supplied to affiliates over the entire world. There could be innumerable reasons for price differences: divergent market conditions, quantities, discount rebate clauses, quality specifications, terms of payment, invoice currency, transaction level of the importer, services rendered in addition to goods shipped and others. Routine disclosures of transfer prices without exhaustive explanations would not serve any useful purpose. Besides, many of these elements varied from day to day and it would not be proper or realistic to expect transnationals to disclose all the details.

Screening Process

In order to ensure maximum benefits for the host country the Group recommended the setting up of centralized negotiating services or co-ordinating groups to deal with all proposals for foreign investment especially from
transnationals. The negotiating services or coordinating groups could also simultaneously evaluate the proposal to see that appropriate technology was being transferred. 42

Mr. Javits disagreed with the idea of setting up of any such machinery for screening and handling foreign direct investments because, he felt, that government officials were not likely to be qualified to pass judgement on the technology being presented by transnationals and might opt for labour-intensive technology for domestic political reasons thereby shutting off more advanced technology inflows. He also had reservations of the rights of governments to discourage or even prohibit in some cases the importation of certain products or their local manufacturing which they considered socially undesirable. 43 Therefore, he did not think that any screening process was really necessary. He, of course, did not consider the possibility that the screening agency could take expert advice on technological and other matters.

Mr. Schaffner reinforced Mr. Javits' contention when he contended that nobody could have his bread buttered on both sides. If the host country preferred an intermediate level of technology, which was not very economical but which created a large number of jobs, instead of highly
capital-intensive competitive automation, it had already made a choice which inevitably excluded competitiveness on the export side. 44

Other Areas of Disagreement

Even in those areas in which there was agreement, there were ambiguities. Mr. Komiya for instance found the recommendations themselves to be contradictory. On the question of jurisdiction and extraterritoriality for instance, it was not for the home country, as suggested by the Group, but for the host country to regulate the behaviour of the multinationals. 45 On the one hand, Mr. Komiya pointed out, the Group did not want the home country to govern the behaviour of an affiliate of a transnational once it was established in another country. On the other hand, when the end was desirable, the report required the home country to exercise jurisdiction. For example, home countries were required to insist that transnationals follow certain internationally accepted labour standards as conditions of foreign investment. They were also required to impose sanctions on corporations that disregarded them; prevent transnationals from investing in countries where workers' rights were not respected; to take strict measures against their nationals giving bribes or indulging in other corrupt practices in host countries;
and to unilaterally prohibit export of products prohibited in home countries for reasons of consumer protection. But Mr. Komiya argued, matters concerning labour standards, labour relations, consumer protection, pollution control and punishment for bribery were all internal affairs of the host countries and should, therefore, be their jurisdiction. At best, what the home country could do was to lay down voluntary guidelines for its transnationals.

Evaluation

Thus, there were major differences between developed and developing countries in areas of ownership and control of transnationals, regulation of products to be manufactured, dispute settlement process between host countries and transnationals, technology transfer, regulation of intra-corporate affairs, disclosure of information by transnationals and in the setting up of screening process for transnationals.

The areas of agreement were national treatment, use of transnationals for other than economic purposes, consumer protection and labour standards. But all of these are not necessarily matters of top priority concern for host countries. For instance, labour relations would not be the most important objective for developing countries. As Mr. Komiya realised, it was important for developing countries, which were mostly overpopulated, to take advantage
of labour, an important and abundant resource. They had to develop and export labour-intensive products, taking advantage of low wages in their countries. Consequently, it was necessary for them to keep wages as close as possible to levels commensurate with the standards in the country. Artificially high wages would limit employment opportunities in industry because the country would not be able to afford it.

Developing countries had really to use low wage labour with high-productivity technology to result, not in high profits, but in low product prices which would bring more products within the reach of average man and raise standards of living, or which could be competitive for exports and thus improve the economy. Hence it was essential for governments to ensure that excessively high profits were not earned by transnationals because of their monopolistic position.

The attitude of developed countries as it became evident in the comments of representatives from USA and Switzerland was, that it was in the interest of the host countries to have transnational investment and, therefore, they had to allow them to make sufficient profits to make their investment attractive.
Taken on the whole, the point of view of developed countries seemed to be that host countries should exercise only minimal control at all over transnationals. They should not screen the investment plans for the transnationals; which they considered socially undesirable. Guidelines were sufficient for the transnationals but more detailed instructions or control would be perceived as suffocating surveillance and as an attempt to reduce the profits of the transnationals which would make investment itself unattractive for them. Terms and conditions such as gradual reduction in equity would also be an inhibiting factor. In any case, the government of the host country did not always know best or would it always act in the best interests of their people. Indeed, a very high degree of freedom was demanded for the transnationals.

Mr. Irwin Miller's comments made this attitude particularly clear when he explained that transnationals had a valid though a limited role in development, and with the exception of extractive industries, it was not at all clear that they had been or would be eager to invest in developing countries. Many of the recommendations of the Group, he said, called on one way or another for constraint, regulation or special conditions for operations of the transnationals and the cumulative effect of these recommen-
dations would be the control of the transnationals. But, he felt, that the developing countries were wrong to assume that the transnationals were all extremely eager to invest in their countries. Developed countries with their larger markets, greater per capita consumption, and sometimes more stable governments, usually offered more attractive homes for the transnationals than developing countries. Hence, he reiterated, it was important for the host countries to offer attractive conditions for entry if they wanted to avail of the benefits of those specific services which they wanted from the transnationals. The bargaining power of the host country lay mainly in the quality, size and stability of the market it offered. The more attractive and important the opportunity, the more effective was the bargaining position. Without detailed insight and knowledge about how a transnational operated, a host government could not hope to establish sound policy and so should not attempt to regulate or control them.

The implication of these comments was that if the developing countries wanted the benefits which transnationals brought with them, they had better make it as attractive as possible for transnationals to invest in their countries. And the way to make it attractive was to have the minimum possible interference in the activities of the transnationals.
Mr. Schaffner further reinforced this view by pointing out that it was wrong to assume that sophisticated high-technology manufacturing transnationals were keen to invest in developing countries because of cheap labour. In fact, a survey of the investment policy of US transnationals showed that they preferred to invest in the advanced, more highly industrialized higher-wage countries where economic conditions most closely resembled those in the US. Cheap labour was only a comparative advantage which developing countries could offer to multinationals dealing with very specific labour-intensive branches. The more capital-intensive the industry and the more advanced the technology, the less justification was there to assume that the transnational had invested in a particular country to take advantage of low labour costs. Labour and land costs were the only two elements in the whole enterprise which were cheaper in developing countries but these advantages were outweighed by the lower productivity of this labour. Thus, while wages per capita were lower in developing countries, the labour cost per manufactured unit and, even more, the overall costs per unit could be higher. And the valid criterion for an enterprise was the overall cost per unit and not the per capita wage. Of course, Mr. Schaffner did not explain why the transnationals had invested in developing nations if there were
Mr. Komiya did not take such an extreme position. He advocated a selective approach to foreign investment and importation of technology for developing countries as an integral part of their development policy. The degree and kind of government intervention depended on the stage of development of the country, the area of investment and the kind of technology transferred. Moreover, some countries, he acknowledged, might prefer a certain degree of economic and cultural independence even at the cost of immediate economic gains. Short-term losses because of restrictive policies towards the multinationals might be offset in the long run if they helped to build up domestic managerial experience and to strengthen the self-confidence of a country's citizens.

Mr. Komiya felt that there was no reason for host countries to feel in a weak bargaining position with the multinationals because no matter how small a sovereign State was, it could always be more "powerful" than the transnational and thus regulate or control it. It could lay down conditions under which the transnational was to establish subsidiaries within its borders, or restrict and regulate the operations of multinationals when they were
established, or nationalize them. He was, however, being unrealistic because it was against these very powers that members from the USA and from Switzerland were protesting. The use of these powers, they claimed, could make the investment so unattractive that the transnationals would not invest and hence the host countries would be deprived of the benefits that could accrue from them. The host developing countries could hardly ignore these views expressed by the representatives of developed nations since the major part of foreign investment came from developed countries.

Conclusion

The impression created by the comments of the representatives from USA and Switzerland was that the transnationals would be doing the developing countries a favour by investing there. The position of the Japanese representative was not as extreme but what was generally implied by the developed countries was that if the host developing countries wanted the benefits from foreign direct investment, they had to go out of their way to woo it. A more objective position was taken by Mr. L.K. Jha, Chairman of the Group of Eminet Persons, and also the Indian representative. While he accepted that "the great contribution of multi-
national corporations" could not be "doubted" in "raising the levels of world production." He also pointed out that it would be "naive" to believe that multinational corporations would go to developing countries if their earnings and growth are not as good as they are in developed countries. In effect, transnationals invest in developing countries because they find it commercially a profitable proposition. Through their investments they also contribute to the development and economic growth of host developing countries.

What is really necessary is to devise policies on an international level that can be beneficial to all parties concerned: the host countries, the home countries and, of course, to the transnational corporations themselves. All concerned can benefit if the transnationals can invest confidently in the developing countries and if these countries, in turn, can have more confidence in the behaviour of the transnationals.
CHAPTER II
FOREIGN DIRECT INVESTMENT IN PERSPECTIVE

Introduction

The divergence of views between developed and developing countries is mainly because of two factors: the majority of developing countries are erstwhile colonies, and they have missed the industrial revolution which was also a technological revolution. They are starting on the process of development as late-comers with its accompanying disadvantages. It is essential to appreciate the impact of these factors on their development.

Canada is in a unique position. It is a developed country with a broad industrial base and highly sophisticated technology. At the same time, it is essentially a resource exporting country. Besides, it has a powerful neighbour, the United States, which is Canada's chief trading partner and also its main source of foreign direct investment. This makes Canadian economy very interlinked with that of the US and, to a large extent, dependent on it. Being an essentially resource-based country and having US, the more dominant economy as its neighbour, generates a sense of insecurity in Canada which manifests
itself in some concerns similar to those of developing countries with regard to foreign direct investment. Thus, Canada can understand the points of view of both the developing and the developed countries.

The basic problem in Canada has been how to take advantage of the benefits emanating from investment from USA while, at the same time, achieving the objects and purposes of an independent, self-respecting nation. The issue in India, as in all developing countries, is a more economic one. It is the use of development to attain a minimum level of subsistence for millions of people who are subject to daily privations affecting their lives and human dignity more profoundly than any statistics can show without compromising the interests of an independent State.¹

What is Development

Three important criteria can be used to define development.² The first is the failure to utilize fully the potential economic output possible by the application of existing technical knowledge because of obstacles inherent in "social" institutes internal or external to the country. In this sense, all countries are "underdeveloped" because no country is able to fully utilize its productive potential. It is even more difficult to do so in a country as
diverse as India with its multiplicity of religions, languages, and social customs. Besides, time-worn institutions like caste coupled with ignorance and illiteracy also prevent the full utilization of the available economic output. In this sense, development is a social problem.

The second criterion is that a country may be underdeveloped compared to another country. In this sense, development is a relative phenomenon and underdevelopment only a question of degree. Economic attainment brings with it both economic and political power. This, in the comparatively less developed country, generates a feeling of insecurity and a feeling of dependence, real or imaginary. This phenomenon is reflected in the foreign direct investment policies of Canada. It shows Canada's essential feeling of insecurity with respect to USA, a much higher and more powerful neighbouring economy, the single most important trading partner. The uncertainty in Canada is not about the desirability for foreign direct investment per se but about the consequent control over large sectors of economy by one country. Accompanying it is the fear of losing a certain degree of sovereignty and cultural identity.

The third criterion is the failure to provide acceptable standards of living to a large percentage of
the country's population who live in conditions of misery and material deprivation. These conditions can only be alleviated by rapid industrialization through the application of technology available mainly in developed countries. Thus, failure to utilize the full technological potential for economic development does not pose a serious problem in developed countries, but results in large scale want and poverty in developing countries. This is the most serious consequence that developing countries face of having missed the industrial revolution and the accompanying technological explosion.

Differences Between Developed and Developing Countries

Colonization and Time of Industrialization

While the developed nations of today were industrializing, colonized countries like India were kept in the pre-industrialization stage. The time lost had serious consequences as has been demonstrated by writers like Barbara Ward and S. Kuznets. Most of the "southern" economies were introduced to modernisation by Western industrial countries but since they were not in command of their own economies, they could not take several vital decisions which could have changed the pattern and quality of their economic life. They were stimulated to the beginnings of economic growth by the need of the North Atlantic for raw
materials, tropical products and certain temperate food supplies. The world market was, thus, organized to exchange "southern" primary products for "Northern" manufactured goods. This led to the development of the local import-export sector but did not have much of an effect on the rest of the economy, because it was largely under foreign control. For example, textile industry which had traditionally been strong in India was crippled instead of being strengthened by the policy of the British Government of taking Indian cotton for the Lancashire mills and bringing in cheap finished cloth for sale in India. The breakup of traditional Indian industry continued throughout the nineteenth century as old industries of shipbuilding, metal working, glass, paper and many traditional crafts suffered.

The export of raw materials paid first for the initial investment required to extract the raw materials and to transport them and then whatever purchasing power they generated was used to buy the manufactured finished products imported through large Western trading companies. What was needed was strong governmental intervention to modernize agriculture, mobilize savings and build up protective tariffs to stimulate the growth of local enterprise but since there was no government will to break the bottle-
necks, the barriers to wider modernisation remained.

From this point of view, as Barbara Ward points out, India and Japan present a striking contrast. In colonial India, some industrial development took place where entrepreneurial talent was locally strong, as it was around Bombay but the industrial growth in India was very slow compared to that in Japan mainly because India did not have political independence to carry out reforms and stimulate the process of growth. Japan took important steps for development like reform in which compensation was given to landlords in government bonds which could only be invested in government-established industries; mobilisation was done of credit in country and town; literacy drive was undertaken; and the government sponsored overseas training of personnel. In India, on the other hand, there was no sponsorship of industry, land reform was not touched, there was no effort to increase the general education, and the government did not even impose a tariff for the protection of new industry till 1920. It was only in 1947 with the establishment of an independent government that India began to tackle economic problems that Japan had been dealing with since the 1870s. Of course, it is not necessary that a local government as opposed to a colonial government will take the right economic decisions but at least it has the
potential to do so. A colonial government has no will to take these decisions because it lies in its interest to keep its colonies a ready source of cheap raw materials and markets for its manufactured goods.

Population

The late industrialization has had an impact on population. Scientific advances have led to the doubling of the expectancy in the developing countries even with the moderate health measures available. The life expectancy in India, for example, was twenty-seven years at the time of independence. It is now, fifty seven years. This, together with the traditional rate of fertility and lowering of infant mortality has made population a major hurdle in any process of modernization of the economy. The rapid increase of population because of health measures before modernisation in other spheres has created dilemmas for the developing world which the Atlantic World largely avoided. When growth of population takes place after a breakthrough into greater mechanisation and productivity, it acts as a spur to further growth because it stimulates the economy to further expansion to meet the increase in demand. Technology has increased productivity in such a startling way that profits and wages go up together. The ability to consume and the incentive to invest are not
contradictory. They reinforce each other in the modern mass-consumption economy.

The outlook reverses when population expands ahead of productivity. To introduce rapidly changing modern technology in farming and industry requires greater saving. But longer lives and more months to feed push up consumption at the expense of saving. In Canada, for example, an increase in population means larger markets for industrial output. In India, population is a major stumbling block in development. Hence the time-factor in industrialization -- industry first, health later or health first and industry later -- has a profound impact.

Technology

Further, technology has developed according to the needs of the developed world and is not necessarily the one suitable for developing countries. The whole weight of economic research and of investment in further research is confined to developed countries who have spent most of the time trying to find labour-saving methods of production. That is, the effort has been to substitute machines for manpower. In addition, it is designed for large units and for large markets. But large scale labour-saving methods are not the most suitable for developing countries where labour is abundantly available.
This dilemma was not faced by the developed world because it invented and adapted technology for its own needs as the process of development went on. The developing countries have neither the time, the resources nor the knowledge-pool with which to develop technology for their own needs. Technology is now already available and can be purchased. It is this technology which the developing countries purchase in their effort to hasten the development process. Thus advanced industrial technology is often used in countries where there is neither the market nor the skills nor the managerial capacity and the required infrastructure to make this technology work successfully. The situation is aggravated by the high cost of purchasing this inappropriate technology. It also leads to imbalance in the development of industry because factories are set up which produce goods which nobody can buy locally either because they are much too expensive or they are not suitable for the living conditions in that country but which, because of inadequate expertise cannot qualitatively compete in the world market.

Products which are useful for developed countries are not necessarily the ones which are required by the developing countries. Barbara Ward gives an example. If, as a cheap by-product of petro-chemicals, Western
industry can produce a substitute for binder twines which are only half the price of "sisal", the consequences from the point of view of petro-chemical interests are beneficial but for Tanzania and for large parts of Kenya, it is a disaster because "sisal" is an important export for them in their limited range of exports.

Psychology

The result of being late-comers is that the aims and ambitions of developing countries tend to be determined not by local experience but by what they can see has been achieved by the developed countries. Countries which have just acquired the means of political and economic decision-making want to quickly command the whole range of opportunities which they know the developed countries already have. They want to take one "big leap forward" to bridge the gap between their own restrictions and other nations' opportunities. Their people want it too. The dissatisfaction is heightened by the past colonial experience because the argument that fired the popular imagination was that poverty was the result of colonization and that once the colonial rule was abolished, prosperity would return. In an average mind, the fact that development process lasts several decades and that it depends on several inputs is overlooked or forgotten, or viewed with resistance and
and resentment. This disproportion between what people want and what they can actually quickly have causes frustration and unrest.

Further, as Kuznets points out, the total economy can only grow as rapidly as the society is able to adjust itself to its continuous expansion. If an economy is a slow-growing one, its institutions are geared to a low rate of growth and require substantial modification if the pace of growth is to be accelerated. But this requires the breaking of old customs, traditions, modes of working and psychological adjustments which the people find hard to make.

Problems faced by developing countries

Kuznets has demonstrated that colonization and consequently the time of industrialization have increased the problems faced by developing countries today. If we judge by the per-capita income in the post-World War II period or in the period between the two world wars, the leading countries were the United States, Canada, Australia, New Zealand, the United Kingdom, Switzerland, the Scandinavian countries, Germany, Netherlands, France and Belgium. The question arises whether at any point of time these countries lagged behind any leading economies of their time as do the developing countries today. For the relatively
"empty" countries like the United States, Canada, Australia and New Zealand, the question does not have much relevance because it involves only pioneers who suffered material deprivations compared to the deprivations in the developing countries today. But these hardships were because of pioneering and not because of economic backwardness. Once the settled groups were significantly large, these countries did not much lag behind the economic leaders. Thus, Canada was developed through foreign investments from Great Britain and United States. There is no comparable situation when the developed countries of today had per capital incomes so far behind the economic leaders of their time and at such low levels as do the developing countries of today.

The technological and economic revolutions in most countries at the top today dates back to about a century and a half or to about two centuries. Thus the older members of the European community which are developed today had a long period of learning process which ripened them for the industrial technological revolution and during this period, the political independence and initiative of these countries was preserved. Most developing countries of today remained outside the orbit of this process of learning, missed the industrial revolution, and now face the problems of development after decades if not centuries of political
subjugation which has left a heritage against which they have to struggle. They have to use the available knowledge not from a position of near leadership where they can adapt this knowledge to their own needs but from the position of laggards whose internal organization has often been distorted by political subjection.

The essence of development is the application of science to problems of economic production which produces both an agricultural and industrial revolution so that the agricultural needs can be met by a fewer people occupied in it. As Kuznets points out in developing countries today, three-fifths or more of the labour force is occupied in agriculture whereas only one-fifth or less is occupied in developed countries. We have to go back a century or a century and a half when three-fifths of the labour force in developed countries of today was occupied in agriculture. Not only that, the per capita in these countries around 1850 ranged from $150 to $300. At constant prices, according to US estimates in 1949, the per capita income in developing countries was $30-$60. Thus, in 1949, the per capita income in developing countries was about one-third to one-sixth of what was the per capita income of presently developed countries in the 1850s. Therefore, the developed countries of today were economically several
times better off than the developing countries of today.\textsuperscript{13}

**Special Features of Canada**

The differences discussed above exist between Canada and India as representatives of a developed and a developing country. However, Canada shares some concerns similar to those of developing countries because a major part of its exports are still resource-based like those of developing countries or "semi-industrial" countries, as Alfred Maizels calls them;\textsuperscript{14} and also because it has feelings of insecurity being neighbour to the most powerful economy in the world, the USA.

**Canada, resource-based country**

As has been pointed out in *Canada and the International Political/Economic Environment*, Canada's merchandise exports contains only a small proportion of finished goods compared to other developed countries. By the mid-1960s, Canada's policy-makers became aware and concerned that despite the Auto Pact with US, Canada, unlike other developed countries which relied on finished goods for at least 50\% of exports, was still predominantly an exporter of raw and semi-processed goods rather than of finished goods.\textsuperscript{15} Some writers went to the extent of calling Canada an "rich industrialized under-developed country."\textsuperscript{16}
Industrialization has been associated with economic development because it leads to an increase in labour productivity and in real incomes. Industrial growth also enhances trade potential. Thus, the industrial growth rates of various countries can be measured by their share of world export market in manufactures. According to Williams, a high-level of manufactured exports is a characteristic of economic development whereas an export structure consisting largely of primary products and intermediate or semi-manufactured products indicates underdevelopment. Alfred Maizels has divided countries into three groups: industrial, semi-industrial, and non-industrial, based on the value of their production of manufactured goods per head and the proportion of manufactured goods in their exports. The following table shows the export performance of countries as classified by Maizels:

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial Countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>31</td>
<td>43</td>
</tr>
<tr>
<td>Italy</td>
<td>31</td>
<td>41</td>
</tr>
<tr>
<td>Germany (Federal)</td>
<td>46</td>
<td>54</td>
</tr>
<tr>
<td>Sweden</td>
<td>23</td>
<td>26</td>
</tr>
</tbody>
</table>

Table II contd...
As the table shows, in the industrialized countries finished manufactures account for at least half of their total exports. In the semi-industrial countries, 10 to 25 percent of exports consist of finished manufactures; and in the non-industrial countries, the share of manufactures is less than 10%.

A corollary to the proposition that high exports of finished manufactures indicate high levels of industrial-
lization, suggested by Maizels is that the larger industrial countries are less dependent on imports of manufactures than the smaller industrial countries and the semi-industrial and non-industrial countries. All industrial countries except Canada, as shown in the table, have positive trade balances in finished products. Even in 1984, Canadian exports of finished products account for 42.1% of total exports well below the desired 50%. Not only that, 66% of total imports by Canada are of finished manufactures.

A further point has been made by Williams. He feels that Auto Pact exchanges can be left out from Canada's external trade picture when it is seen as an indicator of a nation's ability to compete industrially within the world economy. Export of manufactures was stimulated by the Automative Products Trade Agreement with USA in 1965. In 1954, automobiles and parts comprised of only 1% of Canada's exports but in 1984, they account for 26.5%. As a result, the total exports of finished products jumped to 38% in 1970s. Even in 1984, when 42.1% of total exports was of finished products, automobiles and parts consisted of 26.4%. This leaves Canada "in the company of Brazil and India." Of course, as Williams accepts, there are other elements like "relatively high value of Canada's per capita production" which places it among industrial nations rather
than semi-industrial nations. But the fact that Canada is essentially a resource-based country does make it share some concerns with developing countries.

Many explanations have been given for Canada's weak export performance in the manufacturing sector like: comparative trade advantages in resources rather than in developing industrial specialization, a high degree of foreign control over industry; protective tariff policies which protected Canadian manufactures unable to compete in world markets; small domestic market which is a hindrance to economies of scale; and the interlinking of Canadian economy to a far more powerful economy which has relegated Canada to "a resource hinterland role." These are the very factors which, as we shall see later, which have been cited as costs that Canadian economy has paid for the high degree of foreign direct investment.

Influence of USA

Chiefly because of geographical proximity, it is but natural that the relationship between Canada and US is probably closer than between any other two countries in the world and the impact of the influence of the United States, the more powerful neighbour, extends into virtually every aspect of the national life of Canada. People have settled in a narrow band of territory north of US because
of climate and topography. There are personal and family connections across the border. There is similarity in culture, in religion; in the professions, in business, in labour, in education and in the arts.

Stretching parallel with US across the Continent, it was logical and almost inevitable in many ways for Canada with its relatively empty huge land mass to draw on the experience, knowledge and accomplishments of the US. As has been pointed out in the Wahn Report, Canada naturally drew upon the capital of the United States, their people and their skills in its development. For example, in coping with the communication and transportation problems the same techniques were used which had been developed in the US earlier. When it came to the settlement of the vast empty spaces of the west, the techniques of settlement which had been used in the US were copied exactly in the Canadian case a good many years later. The techniques used for developing the big and greatly specialized industries like the agricultural industries, mining and others, were copied exactly from what had been done earlier in US. In areas of pulp and paper, mining, iron ore, oil and gas, and potash, vast amounts of capital and high technical skills had to be developed and used. At the same time, very large markets were needed if they were going to be successful.
The requirements of the United States, especially after Second World War, opened up large markets for many of these items which made it possible to develop these huge industries in Canada. Thus, all the required ingredients for development -- large markets, finance, management, application of technology -- were available in the United States which naturally led to a very large amount of American participation in Canadian economy. The technical and scientific pre-eminence of USA after the Second World War has left its impact over the industries of the whole world because the essence of development after the Second World War has been the rapid expansion of science and technology and its application to industry. Canada being so close to USA, inevitably felt the impact of this on its own industrial developments. Of course, together with technology came investment and management skills but the fundamental factor was predominance in technological and scientific areas.

USA is a natural market for Canada and this has made it Canada's biggest trading partner. The trade between the two countries is the largest between any two countries in the world. Access to the US capital market has been of vital importance to the Canadian economy and private US investment has played and continues to play a
significant role in Canadian growth. There are no two countries in the world between which economic relations are more massive and more all-embracing than they are between Canada and USA. Each country is the other's chief customer.

The majority of Canada's exports go to USA, and the majority of imports to Canada come from USA. The two-way trade between the two countries has increased and not decreased over the years. In 1954, imports from USA into Canada accounted from 72.4% of total imports. In 1984, they are still 72%. However, exports from Canada to USA have shown a remarkable increase. In 1954, Canadian exports to USA accounted for 59.8% of total exports. In 1984, 76.3% of Canada's total exports go to USA. The Report of the Macdonald Commission focuses on the importance of access to the American market for Canada's economic growth and plea for freer trade with US turns mainly on this argument.

Not only are there close trade ties between Canada and USA, the major portion of investment in Canada also comes from USA. As can be seen from the tables below, USA is the single largest investor in Canada and accounts for over 50% of foreign investment. The second largest
investment is by UK -- about 10% -- which is far less than that of USA.

Table III

TOTAL (CUMULATIVE) INVESTMENT IN CANADA: IN PERCENT: BY COUNTRIES

<table>
<thead>
<tr>
<th>Country</th>
<th>Direct</th>
<th>Foreign-controlled</th>
</tr>
</thead>
<tbody>
<tr>
<td>The USA</td>
<td>Over 50%</td>
<td>64 billion</td>
</tr>
<tr>
<td>The UK</td>
<td>About 10%</td>
<td>8.6 billion</td>
</tr>
<tr>
<td>West Germany</td>
<td>Less than 10%</td>
<td>2.7 billion</td>
</tr>
<tr>
<td>Japan</td>
<td>Less than 10%</td>
<td>1.8 billion</td>
</tr>
<tr>
<td>France</td>
<td>Less than 10%</td>
<td>1.3 billion</td>
</tr>
<tr>
<td>Sweden</td>
<td>Less than 10%</td>
<td>1.2 billion</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Less than 10%</td>
<td>1.8 billion</td>
</tr>
<tr>
<td>Italy</td>
<td>Less than 10%</td>
<td>1.6 billion</td>
</tr>
</tbody>
</table>

TOTAL (CUMULATIVE) INVESTMENT IN CANADA AS OF END OF 1984

<table>
<thead>
<tr>
<th>Country</th>
<th>Direct C$</th>
<th>Foreign-controlled C$</th>
</tr>
</thead>
<tbody>
<tr>
<td>The USA</td>
<td>48.6 billion</td>
<td>64 billion</td>
</tr>
<tr>
<td>The UK</td>
<td>5.3 billion</td>
<td>8.6 billion</td>
</tr>
<tr>
<td>West Germany</td>
<td>1.7 billion</td>
<td>2.7 billion</td>
</tr>
<tr>
<td>Japan</td>
<td>603 million</td>
<td>611 million</td>
</tr>
<tr>
<td>France</td>
<td>812 million</td>
<td>1.8 billion</td>
</tr>
<tr>
<td>Sweden</td>
<td>322 million</td>
<td>385 million</td>
</tr>
<tr>
<td>Switzerland</td>
<td>816 million</td>
<td>1.3 billion</td>
</tr>
<tr>
<td>Italy</td>
<td>62 million</td>
<td>126 million</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>1.1 billion</td>
<td>1.8 billion</td>
</tr>
<tr>
<td>Belgium &amp; Luxemburg</td>
<td>481 million</td>
<td>1.6 billion</td>
</tr>
<tr>
<td>Norway</td>
<td>322 million</td>
<td>385 million</td>
</tr>
<tr>
<td>Tax (The Bahamas</td>
<td>122 million</td>
<td>168 million</td>
</tr>
<tr>
<td>Havens (Bermuda)</td>
<td>662 million</td>
<td>415 million</td>
</tr>
</tbody>
</table>

Approximate Total: 60.7 billion 83.8 billion

Source: Investment Canada, Ottawa.
Thus, USA is a very important factor in the formulation of Canada's trade and investment policies. As is pointed out in the Report of the Macdonald Commission, the fact that USA dominates Canada's trade picture is extremely significant for Canada because Canada is a far more trade-dependent country than USA. About 20% of everything produced in Canada is sold to USA while the comparable figure for USA is only 2% or less.\(^{27}\) Thus, the large degree of US investment in Canada and prominence of trade with USA has led to a feeling of dependence on US markets. The third option policy\(^{28}\) enunciated in 1972 was an effort to lessen the dependence. What it meant was that Canada must try to maximize its economic benefits but at the same time, reduce its reliance on United States by diversifying its markets. The policy, however, did not have much success and the report of the Macdonald Commission accepts that since dependence on American markets is inevitable, attempt should be made to secure firm access to them.

In the field of investment, too, the costs of foreign direct investment, particularly of investment from one single country were brought to widespread public attention by the Royal Commission on Canada's Economic Prospects chaired by Walter Gordon,\(^{29}\) constituted in 1955 and which tabled its report in late 1957. These were even more force-
fully highlighted subsequently by the Watkins Report, Wahn Report and by the Gray Report. The cumulative effect of these reports was the enactment of the Foreign Investment Review Act and of the establishment of the Foreign Investment Review Agency. A change of outlook has again taken place as is evident from the Macdonald Commission Report and the enactment of Investment Canada Act.

Conclusion

Thus, the difference in outlook between developed countries and developing countries stems directly from the state of their economic development. While development in some respects is a relative phenomenon — a country may be developed in itself but not as developed as another — for the developing countries it is essentially a question of raising the standard of living to acceptable levels for the vast majority of their populations. The developing countries, because of colonization and consequent lack of industrialization and technical know-how are trying to make up for the lost time. They are working against tremendous odds in trying to accelerate the process of development like lack of resources, technology, infra-structure, skilled manpower, and psychological pressures emanating from the colonial experience. Foreign direct investment for these countries is a means of economic development and has to
be regulated to maximize benefits from it.

Canada is a developed country with a high per capita income, broad industrial base, and sophisticated technology, but it is still a resource-exporting country. Further, it lacks not only a large domestic market but also assured access to any other large market. Being next to a powerful economy like USA, Canada's bulk of trade is naturally with USA. The majority of investment, too, comes from USA. Thus, USA plays a vital role in Canada's economy causing a feeling of dependence and insecurity in Canada. Close cultural similarities with USA accentuate a search for identity. Thus, Canada regulates foreign direct investment to prevent the most important sectors of its economy from becoming largely foreign owned and controlled; and to maintain its own economic and cultural independence.
CHAPTER III

INDIA AND FOREIGN INVESTMENT

The policy towards foreign investment has been shaped in India keeping the following factors in mind: scarcity of foreign exchange resources which necessitates a judicious use of the available exchange in sectors considered essential for development; the need for technology and, therefore, the utilisation of foreign exchange resources for transfer of technology; the perception that it is necessary to have a broad industrial base if the needs of a very large population are to be met; and the firm conviction to be self-reliant strengthened by the colonial experience which brought home the necessity of developing indigenous know-how, skilled man-power, entrepreneurship and managerial skills.

Historical Background

In 1947, when India became independent, she bore the scars of colonial exploitation. India had been conquered before the British came to India, but those invaders had "made themselves part of her life". The British always remained alien. Before the British rule "she had never lost her independence, never been enslaved. That
is to say, she had never been drawn into a political
and economic system whose centre of gravity lay out­
side her soil, never been subjected to a ruling class
which was, and which remained, permanently alien in
origin and character": Having this sense of alienation,
the British remained not an integral part of India but
colonial masters trying to extract what they could from
India. As an example, Kust has pointed out, when indus­
trialization began to gain momentum in England, heavy
duties were imposed on Indian textiles to protect the
mills of Manchester and Paisley but there was no corres­
ponding duty on English cloth exported to India. The
result was that Indian textile industry of Bengal was
ruined. If India had been an independent country, she
would have imposed prohibitive duties on English cloth
which, of course, she now could not do. Those allied
industries which were not in competition with British
industries and which were needed to supply raw materials
to British industries were encouraged especially sericul­
ture and indigo.

The East India Company had been started with the
object of carrying Indian manufactured goods as well as
spices from the East to Europe where there was a great
demand for them. With the development of industrial
techniques in England, the British market was closed to Indian products and Indian markets were opened up for British manufactures. Since East India Company had a monopoly in Indian export business, this exclusion affected other foreign markets also. Duties were imposed which prevented the flow of goods in the country itself too. This led to the collapse not only of the traditionally strong Indian textile industry but also other traditional industries.

Kust argues that as long as technology was dependent on human and animal power, India was the foremost manufacturer in the world because she had developed a socio-economic organisation and had perfected human skills and techniques for the purpose. But Indian society was static, and just as China and the Arab world, which had not suffered similar economic rule, could not adapt to changing technological innovation, India might not have been able to adapt either. Nehru concedes that this collapse might have been inevitable as all traditional techniques became outmoded, but at the same time, points out that no attempt was made to apply new techniques to India. In fact, every attempt was made to prevent this from happening. Machinery could not be imported into India without heavy duties, thus creating a lucrative market for British goods and at the same time
leading to unemployment and poverty. It was only in 1860 that the duty on machinery was removed. It led to an economy which Nehru calls a classic modern colonial economy by which India became an "agricultural colony supplying raw material to industrial England and providing a market for England's industrial goods."

The artisan class, deprived of their traditional employment were driven to the land but the land could not support them. Poverty grew while it led to an ever-growing disproportion between agriculture and industry. As agriculture became increasingly the sole occupation of the people, land holdings became more and more fragmented. With poverty, the small land holdings too often passed into the hands of unscrupulous money-lenders so that the number of landless labourers increased rapidly.

It was not until the end of nineteenth century that anything resembling modern industry began to develop in India. The British emphasized export-oriented industries of primary products like indigo, tea, jute, manganese, mica and others, but had no interest in developing basic industries like iron and steel, chemicals, and machine making. They preferred to export these to India and since these industries required capital and know-how difficult for Indians to acquire, they remained under-developed. Trans-
port and communication facilities, especially railways and coal production to run the railways, were developed to move these products. India paid a heavy price for it, but the need and desirability of it cannot be questioned.

India's capacity to industrialise can be seen from her attempts to do so in spite of active discouragement. Cotton textile industry was developed by Indians with equipment and technical assistance from England. The British were in two minds about it. While Lancashire mills agitated against it, the British textile machinery manufacturers favoured its growth because it served to promote their exports. One of the early founders of textile industry was Jamshedjee Tata, a name that was later to become foremost in Indian business and industry. Jamshedjee Tata also established a steel mill for India, and its success was due to American technical assistance. By World War II, India, with the exception of Japan, had the foremost steel industry in Asia. It was, however, the only example of heavy industry in India. The colonial experience left an impact on the psyche of both political and business leadership. Indian business leaders although committee to free enterprise became wary of foreign investment. Sir Rahimtoola M. Chinoy in the name of Indian Merchant's Association went to the extent of demanding repatriation of all
British investments in India "with the help of our accumulated [sterling] balances." 7

Convinced that "powerful interests" were "operating abroad for the purpose of throttling further industrialisation of this country"; 8 that "there was a plan -- clear-cut and thorough -- to prevent the industrialisation of this country in the post-war period"; 9 and that "British policy was opposed to any rapid growth of heavy industries controlled and managed by Indians." 10 They were keen to be rid of British control. At the same time, there was also a realisation that India's industries were "pygmies in a world of giants." 11 The demand was that "post-war industrial development of India especially in key industries" would "be the exclusive sphere of Indian enterprise both in respect of ownership and control." 12

The hostility manifested itself in vehement opposition to foreign companies incorporated in India. The delegates at the eighteenth Annual Meeting of the FICCI voiced their resentment at the rapid increase in the number of foreign companies incorporated in India and pointed out that "the so-called India Limited companies ..... are really foreign companies [that] have established themselves in this country ... and ... monopolised most of the larger industries which should otherwise have been
in our hands." The Association of Indian Industries concluded: "The remedy against such corporations being set up in the future is a clear straight surgical operation, namely to delete the ... actions in the Government of India Act [allowing their formation]." The Indian Merchants' Chamber warned that "India would prefer to go without industrial development rather than allow the creation of new East India Companies in this country."

From the above statements we should not assume that Indian business was unanimously hostile to foreign capital. The degree of hostility varied according to business interests of various groups. There was, however, unanimity on one point: Indians must be effectively involved in Indian business and industry. As early as 1928, the Indian Merchants' Chamber had proposed that the Western Indian Match Company be registered in India with three-quarters of its capital held locally and three-quarters of its directors Indian. Even during the Second World War, continued foreign investment seemed acceptable if the basic conditions were satisfied: "It should ... be a condition of the establishment of foreign companies in India that they should have ... Indian capital and Indian representation on the board of management [and] arrangement for the training of technicians."
In 1945, when an officially-sponsored Indian industrial Mission led by J.R.D. Tata and G.D. Birla went to Britain and USA, the visit caused much concern and was seen by many as an "illegitimate marriage" between foreign and domestic big business. It was at the same time recognized that there would have to be "alliances, agreements and contracts" between foreign and Indian industrialists if the country had to be industrialised and the process would cost much less if foreign technical and financial co-operation could be obtained. It was, however, reiterated "that under no circumstances would India allow the control of new industries to be exercised by non-Indians." 

1949 Policy Statement on Foreign Direct Investment in India

The first major policy statement on foreign investment was made by Prime Minister Jawaharlal Nehru on April 6, 1949. It reflects on the one hand the government's acceptance of the need for foreign investment for industrial and economic development and on the other, the conviction that effective control must remain in Indian hands. The following conditions for foreign investment were set out in the Statement:

- there would be no discrimination in the treatment of domestic and foreign enterprise and
all would have to conform to the industrial policy of the country.

- foreign enterprise would be permitted to earn profits, subject only to regulations common to all.

- there would be no restriction on the remittance of profits or repatriation of capital, but remittance facilities would naturally depend on the foreign exchange situation.

- if foreign interests came to be compulsorily acquired, compensation will be paid on a fair and equitable basis and reasonable facilities will be provided for the remittance of proceeds.

- the major interest in the ownership and effective control of an undertaking should, as a rule, be in Indian hands.

- Indians should be trained and employed in managerial and technical posts as quickly as possible.

An illustrative list of industries in which foreign capital was particularly welcome was also published.
The first four conditions reflect a desire to encourage foreign investment by promising national treatment; free repatriation of profits and capital except when there are foreign exchange problems; and fair and equitable compensation in case of nationalization together with facilities for remittance of proceeds. The determination to follow an independent economic policy is reflected in the desire to keep the ownership and control of foreign investment in Indian hands and in the perceived need to develop local entrepreneurship, skilled manpower and managerial talent.

The First Five-year Plan further elaborated on the principle stated by Mr. Nehru along which foreign enterprise was to be encouraged in India.

In view of the fact that the investment of foreign capital necessitates the utilization of indigenous resources and also that the best use of foreign capital is as a catalytic agent for drawing forth large resources for domestic investments, it is desirable that such investment should be channelled into fields of high priority. The broad principle to be followed is that foreign investment should be permitted in spheres where new lines of production are to be developed or where special types of experience and technical skill are required or where the
volume of domestic production is small in relation to demand and there is no reasonable expectation that the indigenous industry can expand at a sufficiently rapid pace. The system of joint enterprises under which a number of foreign concerns have established new industries in the country in collaboration with Indian industrialists appears to be suitable for securing employment of equity capital. Agreements for such joint participation between foreign and Indian concerns should be subject to approval of Government. The share of national capital in joint enterprises, the facilities for the training of Indians, the disclosure of patented processes to Indian associates, etc. are matters which have to be decided with due regard to the facts of each particular case.  

Therefore, participation in new industrial undertakings is desired but only to the extent needed. These attitudes have been an integral part of policies towards foreign investment in India.

The policy of inviting foreign investment in selected fields was once again stated by Mr. L.K. Jha, the Indian representative and Chairman of the Group of Eminent Persons, but, as he pointed out, being selective did not necessarily mean being restrictive or biased against multi-
nationals. It would be naive to believe that multinationals would go to developing countries if their opportunities, earnings and growth were not as good as in developed countries. It is, he felt, too simplistic a view to take that since developing countries need capital and foreign exchange, they must woo private investment. Infact, if the developing countries make the right choices after taking into consideration all the alternatives, the relationship they forge with the multinationals will be a more healthy and a more stable one. An analysis of perceived costs and benefits of foreign investment in India would validate a selective approach.

Costs and Benefits of Foreign Investment as Perceived in India

It is generally accepted that foreign direct investment brings some obvious advantages to a developing country. Its importance has been recognized by the United Nations. In the Action Programme of the General Assembly for the Second United Nation's Development Decade it was said

"Developing countries will adopt appropriate measures for inviting, stimulating and making use of foreign private capital, taking into account the areas in which such capital should be sought and bearing in mind the importance for its attraction of conditions conducive to sustained deve-
Development. Developed countries, on their part, will consider adopting further measures to encourage the flow of private capital to developing countries." The multinational entrepreneurship are the chief means of foreign direct investment. But together with these benefits they bring with them certain costs.

Many of the costs to developing countries of foreign direct investment pointed out by writers like Simon Kuznets\textsuperscript{25} and Barbara Ward\textsuperscript{26} and voiced in the Report of the Group of Eminent Persons\textsuperscript{27} have been confirmed in the Indian experience as can be seen from Kidron's\textsuperscript{28} detailed analysis of the costs of foreign investment to India.

Technology

It is argued in support of foreign investment that it brings with it much needed managerial and technical skills at little or no extra cost. However, the other side to this is that research and development are invariably conducted abroad and have to be paid for through royalties, fees and other payments. Even then they are not available in their entirety. Through their production and staffing policies investing firms try to keep a continuing control of the know-how. The local investor is assigned a narrowly specialized range of functions and so a diffusion of skills does not take place.
An under-developed country has to use the most productive techniques available in order to raise its capacity to save and invest. Technology has to be imported for the production of certain items, but not all techniques are equally suitable. By wholly importing a technology without adapting it to local needs, an under-developed country can saddle itself with equipment which requires too sophisticated a network of servicing and ancillary industries.

As has been pointed out by Eddison, foreign-made equipment was imported in India which was planned and constructed for use under totally different conditions, for processing different kinds of raw materials and with different grades of chemicals. More highly trained workers than those found in India were supposed to handle it. Hence, the equipment often gave unexpected problems and operated at lower efficiency than it would have in its own land for which it was designed. Further, many of these imported units had automatic devices and mechanical conveyors designed into them which could only be economically justified in countries where labour costs were much higher than in India.

Moreover, in many cases, not only was the equipment unsuitable but it also cost 15-20% more than in its country
of origin because of freight, handling and duty charges. The suppliers, too, followed monopolistic pricing policies taking advantage of the limited options available to the country. There was no domestic machine production and the country was trying to get the best deal possible. There were machines in the paper industry for example from Britain, Germany, Belgium, Sweden, America, Canada and Japan with no sales and service organization in the country.

In many cases, importation of equipment inhibited the development of ancillary industries. In the case of automobiles, for example, as most of automobile engines were assembled or manufactured with foreign collaboration, parts like pistons, piston rings, and others had to conform to the design and specifications of the overseas manufacturers of engines and had to be approved by them. The Tariff Commission recommended that pistons of the required specifications should be produced in India and obtained by individual automobile firms from Indian sources. But this did not make much progress because the individual firms had to first get their products approved from their foreign collaborators. When foreign associates introduced frequent changes in specifications the Indian manufacturers had to conform to them at considerable cost to themselves and little benefit to the consumers. Besides, some manufacturers preferred imported materials even when these
were indigenously available at reasonable prices. Thus, the development of ancillary industries was slow.

Of course, factors like the general lack of indigenous equipment, scarcity of managers, lack of skilled labour and others led to large imports from abroad but the fact also is that the foreign investor normally has a direct interest in supplying equipment and know-how; is almost always in charge of the technical operations of the joint venture; is not very keen to import skills or development information, and may not want to introduce equipment that can be easily copied. Hence, instead of making efforts towards import substitution, he over-imports.

Duplication of Technology

The desire to import technology at a fast pace produced two results: the industry became import-oriented as opposed to development of indigenous know-how; and the situation became aggravated by the foreign collaborator's reluctance to give the complete know-how. International giants naturally tried to take advantage of their technological monopoly. Local private capital was discouraged from developing research in industry because the government seemed so keen to import technology.
The emphasis on imported technology inhibiting local initiative can be seen by an example. An Indian firm had completed arrangements to manufacture ball-bearings and roller-bearings. Machinery had been copied and trials completed when news came of collaboration by another firm with a well known foreign firm. Knowing how difficult it would be to compete with an internationally known brand, the firm entered into an agreement for technical collaboration with another foreign firm only to acquire the use of its trade mark. Thus, the Indian firm was forced to purchase superfluous rights and also the technique was duplicated within the Indian industry through additional, competitive and costly purchases abroad rather than through dissemination of the technical know-how by the original importer.

**Efforts to Augment Capital**

In its anxiety to augment its foreign exchange resources, investments were allowed in low-priority spheres on promise of export of a proportion of the product or to bring in a quantity of foreign exchange. It led to insistence on collaboration with foreign capital as a normal precondition to obtaining a licence. Restrictive provisions in the transfer of know-how were tolerated. Plants were set up by the government which were very capital-
intensive thus imposing a similar structure on private plants. Further, foreign experts were invited at prohibitive fees when equally suitable or even more suitable local ones were available. In many cases, foreign credits were available only if the foreign design was also taken and foreign consultancy was accepted.

Monetary Costs

Various studies of foreign investment in post-independence India have pointed out that foreign private investment is expensive for a country like India. According to a few studies of the Reserve Bank, the American firms were earning an average of 13.5% of net worth in 1953 and 12.8% in 1955 after tax compared with 10-12% at home in both years. British firms earned 11.9% and 9.5% in the two years compared with 8-9% at home. Thus, profits were between 6 and 35% higher in India than at home for these firms. To this has to be added high cost of know-how, licences and such like.

Studies made by US Department of Commerce, Federation of Indian Chamber of Commerce and Industry and Indo-American Chamber of Commerce show that foreign investment in India is as profitable as foreign investment in industrially developed nations. A FICCI study dealing with twenty-five large public limited Indo-UK ventures, with
a minimum capital investment of Rs.5 million revealed that between 1975 and 1980, the total assets of these companies rose by an average rate of 14.2%, the net sales increased by 14%, profits after tax were 20.4%, net profits as percentage of net worth increased from 14.1% to 17.1% and dividends as percentage of share capital increased from 12.3% to 14.9%.\(^\text{32}\)

A study of Indo-American Chamber of Commerce of 34 Indo-US ventures for the period of 1973 to 1981 showed a compound annual growth rate of 18%; net profits after tax 20.3%; dividends were 14.8% and retained earnings were 22.8%.\(^\text{33}\)

Another study conducted by US Department of Commerce shows that US companies in India have earned better returns than those operating in some advanced countries like Canada.\(^\text{34}\)

The high profits are because of the protection given by the government to its industries whether foreign or domestically owned. The expensive nature of foreign equity investment has been demonstrated thus by Kust.\(^\text{35}\) According to his figures, it is possible to get a 400% return on equity investment in ten years. The rapid rate of growth and high rate of dividends do not create a problem as far as domestic equity investment is concerned. But foreign
equity investment does pose a problem. India, as a policy, allows free remittance of profits and repatriation of capital gains to foreign enterprise. Therefore, for every dollar invested, the return in ten years can be up to five dollars. On the other hand, a one-year loan at 6% interest would require a foreign exchange repayment of $1.60 for every $1. It is argued that earnings on foreign capital are reinvested and thus benefit the economy. But profits in rupees generate the potential 5:1 foreign exchange obligation. Even if the interest rate is 10%, the foreign exchange repayment burden would be $2 for every $1 invested in ten years. Such a burden which is incurred by foreign equity investment is only justified when the investment brings with it capital goods and technology needed by the country.

Unemployment

Foreign investments are capital-intensive and this has a dampening effect on the creation of new jobs. But they may be more efficient and so their pattern is followed by indigenous firms thereby increasing the overall loss of jobs. When such investments are in consumer goods industries, two contrary processes are set in motion. Traditional producers are weakened because of mass production of cheap goods so gradually they become unemployed. On the other hand, technologically-intensive investments in modern indus-
trial sector push up skilled wage rates and so build up further pressure in favour of capital-intensive, labour-displacing investment. Thus, a small number of people become high wage earners while at the same time, unemployment increases in the towns. The displaced rural labour which had before been engaged in the production of traditional goods also migrates to towns, being displaced from their traditional employment and adds to the unemployed work force which makes the situation explosive.

Under and Over-Invoicing

The value of many investments was inflated by marking up the prices of goods or materials or services supplied as investment in kind. This was done mainly for two reasons: a foreign collaborator might want to exaggerate the "necessary" import content of the project so that he could get a controlling interest in it; or he might not wish to reveal his real level of profits and so he might manipulate the value of his other payments. This leads to leakage of foreign exchange which the country cannot afford. This was the subject of a study on the Leakage of Foreign Exchange through Invoice Manipulation which was considered before the enactment of Foreign Exchange Regulation Act, 1973.
Foreign Exchange Regulation Act, 1973 (FERA, 1973)

Exchange control was first set up in India in 1939 as a war measure to conserve and direct to the best uses the limited supply of foreign exchange available. The exchange control was made effective through a series of rules under the Defence of India Act, 1939. These rules expired on 30th of September, 1946, but were retained in force for another six months. However, since it was felt that the shortage of foreign exchange would continue, it became necessary to continue the system of exchange control. Thus, the Foreign Exchange Regulation Act was enacted on March 25, 1947, to continue the exchange controls.

The Foreign Exchange Regulation, 1947, had to be amended from time to time to meet the changing needs. It was finally felt necessary to have clear provisions to regulate the entry of foreign capital which would incorporate Government's policy with regard to foreign investment. As mentioned before, at the time of enacting, FERA, 1973, the Government took into account the report of the study team which studied the question of the Leakage of Foreign Exchange through Invoice Manipulation. It also had before it the 47th Report of the Law Commission on the Trial and Punishment of Social and Economic Offences. 37
The problems as stated by the study team was the loss of foreign exchange, which the country could ill afford, through invoice manipulation, smuggling, travel and nest-eggs abroad. The study team estimated that loss of foreign exchange per year was approximately 240 million dollars.\(^{38}\) Most members of Parliament felt that this was a gross under-estimate.\(^{39}\) One of the main objects of the Foreign Exchange Regulation Act, 1973 was "to regulate the entry of foreign capital in the form of branches and concerns with substantial non-resident interest in them..."\(^{40}\) This was done mainly by section 29 of the Act.

**Salient Features of Section 29**

According to section 29(1)(iii), (i) any person resident outside India whether a citizen of India or not, or (ii) any person resident in India but not a citizen of India, or (iii) a company other than a banking company not incorporated in India; or (iv) a company in which the non-resident interest is more than 40% or (v) any branch of such a company; cannot, except with the general or special permission of the Reserve Bank carry on in India, or establish in India a branch, office or other place of business for carrying on any activity of a trading, commercial or industrial nature other than an activity for the carrying
on of which permission of the Reserve Bank has been obtained under Section 28.\textsuperscript{42}

The above-mentioned category of "persons" cannot under Section 29(1)(b)\textsuperscript{43} acquire the whole or any part of any undertaking in India of any person or company carrying on any trade, commerce or purchase the shares in India of any such company except with the permission of the Reserve Bank.

Those "persons" who had already established "businesses" of the kind mentioned in Section 29(1) were under Section 29(2)\textsuperscript{44} required to apply for permission from the Reserve Bank to carry on the activity within six months or such further period of time as may be allowed by the Reserve Bank within six months of the commencement of the Act.

The Reserve Bank can after making such enquiries as it may deem fit, either reject the application or allow it subject to such conditions, if any, as it may think fit to impose.

However, no application can be rejected without giving the concerned parties a reasonable opportunity for making a representation in the matter.\textsuperscript{45}
Where an application is rejected by the Reserve Bank, the concerned party is to discontinue the activity within ninety days or such other later date as may be specified by the Reserve Bank from the date of receipt of the communication conveying the rejection. 46

Where no application had been made for permission to continue the "activity" within six months of commencement of the Act, the Reserve Bank may direct the discontinuation of closure of the activity within a period specified in the direction by the Reserve Bank. But no such direction could be made without giving the concerned party a reasonable opportunity to make a representation. 47

The Reserve Bank may exempt some "persons" from the necessity of seeking permission to carry on an "activity" or to commence it for which permission or licence has been granted by the Central Government before the commencement of the Act, provided the activity is not "solely of a trading nature." 48

Where any such "person" referred to in Section 29(1) held any shares of any undertaking in India carrying on any trade, commerce or industry then within six months from the commencement of this Act or any further period of time specified by the Reserve Bank, permission has to be obtained from the Reserve Bank before these shares can continue to be held. 49
The Reserve Bank can on application and after making such inquiries as it may deem fit, give permission to hold the shares subject to such conditions if any as it may think fit to impose. Or the Reserve Bank may reject the application but not without giving the concerned parties a reasonable opportunity to make a representation in the matter. 50

Where no application has been made seeking permission to hold the shares, the Reserve Bank may direct the "person" to sell or procure the sale of those shares if it considers it necessary for the purpose of conserving foreign exchange. But no such direction can be given to the "person" unless a notice of such a direction has been given to the person for a period at least ninety days. 51

Thus, the Reserve Bank has been given very wide powers for regulating the multinationals. But such wide powers to the executive without guidelines can be fraught with danger. Hence, Section 29 cannot be read without the elaborate guidelines for its implementation.

Guidelines for Administering Section 29 of FERA, 1973

Scope: The Guidelines apply to Indian companies having more than 40% foreign holdings and branches of foreign companies operating in India and seeking approval for carry-
ing on any activity of a trading, commercial or industrial nature or for starting fresh activities. The Guidelines do not apply to investments made by non-resident of Indian origin provided that they do not repatriate either capital or profits or dividends.

Companies with more than Forty Percent Shareholding:

In case of Indian companies which have more than 40% foreign shareholding and branches of foreign companies which are engaged in production of items specified in Appendix I of Industrial Licensing Policy of February 1973 or are engaged in a predominantly export-oriented industry, i.e. at least 60% of their total production is for export, one of the following courses of action is to be followed with regard to them. They can be allowed to continue provided they increase the Indian participation to not less than 26% of the equity within specified time. Branches of foreign companies were required to convert themselves into Indian companies with at least 26% Indian equity participation within a specified period of time. Such companies are to be subject to dilution formula when they came up for examination.

Those Indian companies which had more than 40% foreign shareholding but which had been granted industrial licence after February 1970 for manufacture of items specified in Appendix I of the Industrial Licensing Policy, 1973, or at least 60% of whose production was for exports, were exempt
from section 29 subject to the condition that within a specified period, the company would have Indian participation of at least 26% of the equity of the company.

The extent of foreign holding in case of Indian companies with more than 40% foreign shareholding and branches of foreign companies with valid industrial licence, engaged in the production of an item not specified in Appendix I of the Industrial Licensing Policy, 1973, but engaged in manufacturing activities requiring sophisticated technology are to be considered individually subject to the condition that within a specified period the Indian participation is brought up to at least 26% of the equity of the company.

The branches of foreign companies are required to convert themselves into Indian companies and bring the Indian participation to at least 26% of the equity holding of the company within a specified period.

In determining whether the technology is sophisticated, the Department of Science and Technology is, of course, be consulted but also consideration is to be given to whether the company is using the technology to manufacture products which would otherwise have to be imported; or whether the discontinuation of the manufacture of that
product would have an adverse impact on the company.

Indian companies having more than 40% foreign shareholding and branches of foreign companies engaged in other manufacturing activities would be required to bring down the foreign shareholding to the level of 40% or less within a specified period. Branches of foreign companies would be required to convert themselves into Indian companies with foreign shareholding not exceeding 40% within a specified period. Alternatively, they could change their character within a specified period and shift to manufacturing activities specified in Appendix I of the Industrial Licensing Policy, 1973 or become predominantly export-oriented, that is, export at least 60% of the total production.

Trading Activities

Indian companies with more than 40% foreign shareholding or branches of foreign companies engaged predominantly in internal trading and commercial activities, the course of action would be as follows: No fresh foreign equity participation would be permitted. The Indian companies would have to bring down their foreign shareholding to 40% within a specified period. The branches of foreign companies would be required to convert themselves into Indian companies with not more than 40% foreign shareholding within a specified period. In cases where the company had
developed expertise, skills or facilities like a distribution network which were not available readily indigenously and were contributing significantly to exports, foreign shareholding of more than 40% but not exceeding 74% could be allowed depending on the merits of each case.

Alternatively, within a specified period, they could change their character from predominantly trading activities to predominantly manufacturing activities in areas specified in Appendix I of Industrial Licensing Policy of 1973, or engage themselves in predominantly export-oriented industries exporting at least 60% of their production.

In case none of these options were acceptable, the company would be allowed to wind up within a reasonable time.

Where there were manufacturing Indian companies with more than 40% foreign shareholding or branches of foreign companies engaged in trading activities in respect of products not manufactured by them, they would not be denied permission to continue the internal trade of those products, provided the articles so traded were functionally related to the company's main manufacturing activities and constituted a relatively small portion of the overall activity. The companies could not use their trade marks or brand names
in respect of products internally traded by them but not manufactured by them.

Other Activities

Companies engaged in construction activities and consultancy work, Indian companies have to bring down foreign shareholding to not more than 40%. Branches of foreign companies have to convert themselves to Indian companies with not more than 40% foreign shareholding. In exceptional cases, the higher foreign shareholding not exceeding 74% could be allowed. Tea plantations would be treated at par with manufacturing industries specified in Appendix I of Industrial Licensing Policy, 1973, subject to the condition that Indian participation was not less than 26% of the equity of the company. Branches of foreign companies would have to convert themselves to Indian companies with at least 26% Indian equity participation.

The Explanatory Notes clarify that in giving fresh approvals, aspects such as research and development initiated by the Indian company, stipulations which restrict transfer of technology from the foreign collaborator to the Indian company, restrictions on sub-licensing of technology and stipulations for the acquisition of raw materials and components from the foreign collaborators and existing regulations in respect of patent law are to be considered.
Where a company has many activities, then all the activities have to be considered while giving it permission to continue to do its business. Companies changing their activities would still need to get industrial licences for the new activities. Companies with 100% export-oriented units could be allowed more than 74% foreign equity depending on the merits of each case.

Thus, the import of section 29 read together with the guidelines is that the normal ceiling for foreign equity ownership was 40% of the total equity capital. A higher percentage of equity ownership by the foreign investor — upto 74% or even 100% — can be allowed if the venture is in a sector which is considered extremely important or which is largely or wholly export-oriented. Therefore, the country has to find a venture very essential for its development or the venture must pay for itself through exports before foreigner ownership is allowed. The foreign share has to be contributed by way of cash without being linked to imports or machinery and equipment or payment of know-how, trade-marks or brand names.

Oil Exporting Developing Countries

Realities of limitation of foreign exchange resources have led the government to evolve methods of augmenting
these resources. This has been done by encouraging investments by Oil Developing Countries, by non-resident Indians and by persons of Indian, and by actively promoting exports.

Foreign investment in India has been seen mainly as a vehicle for transfer of technology. So up to 1980, generally speaking, foreign investment not accompanied by transfer of technology was not allowed but the need for capital and foreign exchange led to the relaxation of this policy with respect to Oil Exporting Developing Countries (OEDC). A press note issued on October 28, 1980 by Ministry of Finance allowed OED countries to invest up to 40% in equity of new ventures without being linked to transfer of technology. That is because these countries have large financial resources but may not have the type of technology needed for India. Investment in priority areas like fertilizers, cement, petrochemicals, paper and pulp and others involve large financial outlays but their development leads to greater self-sufficiency and even encourages exports.

Within the framework of investment, the OED countries can invest up to 40% in the equity of new or established companies, but these companies should either be export-oriented or should undertake manufacturing activities covered under Appendix I of Industrial Policy of 1973. Investment of this nature is also allowed in hotels and hospitals on
the condition that the hospital must have adequate provisions for out-patient and emergency medical service to the general public and should provide for a minimum percentage of occupancy by Indians.

Non-Resident Indians and Persons of Indian Origin

Another exception to the policy of foreign investment linked with transfer of technology is the investment made by non-resident Indians and persons of Indian origin. Non-resident Indians are those who stay abroad for employment or business, but are still Indian citizens. Persons of Indian origin are those who have acquired foreign citizenship. Very liberal facilities have been given to them to invest in industry in India with the prior approval of the Reserve Bank of India. Various types of investment can be made by them:

Direct Investment

Non-residents of Indian nationality or origin can invest in any new or existing company in which the non-resident interest is not more than 40% with full repatriation benefits. The investment can be through public issues or otherwise. In case the investment is in a private limited company or in a public limited company where capital is raised other than through the issue of prospectus, non-residents can invest upto 40% of the new capital issues
subject to a ceiling of Rs.4 million.

They can invest up to 74% of the equity capital of a company in any industry listed in Appendix I to the Ministry of Industry Press Note dated 2nd February, 1973 as amended on 21st April, 1982. Such an investment can also be made in hotel industry and in export-oriented industries.

**Portfolio Investment**

Non-residents and persons of Indian origin can make portfolio investments with full repatriation benefits provided (i) shares are purchased through stock exchange; (ii) in any one company the non-resident investor does not exceed 1% of paid up equity capital of the company; and (iii) payment for the investment is made either by fresh investment from abroad or from funds in the investor's non-resident external account. There is, however, a limit of 5% on the holdings allowed to non-residents of Indian origin in the Indian companies bought through the stock exchange with or without repatriation benefits. Beyond 5%, prior approval of Reserve Bank is necessary.

If investment is desired without right of repatriation, it could go up to 100% of the issued capital of a company provided payments are made from abroad or from the non-resident external account. All facilities of direct
and portfolio investments available to non-resident Indians and persons of Indian origin are available to overseas companies, partnership firms, trusts, registered societies and other corporate bodies in which the ownership interest of non-residents of Indian nationality or origin is 60% or more.

Free Trade Zones

Another effort to augment foreign exchange resources is seen in the establishment of free trade zones. Two such zones have been established in India, one in Kandla and in the State of Gujarat, known as the Kandla Free Trade Zone (KAPTZ) and another at Santa Cruz (Bombay) known as the Santa Cruz Export Processing Zone (SEEPZ). Four more free trade zones are being set up in the States of West Bengal, Tamil Nadu, UP and Kerala. They will be in Falta, Madras, NOIDA and Cochin respectively. Industrial units in these zones are meant to be wholly export-oriented units though the Government has allowed these units as an additional incentive, to sell 25% of their output in domestic market.

Investment facilities and incentives are available in these zones like simplified procedures and single point of clearance; no import duties or import licence required
for capital goods, raw materials, components and other items imported for export processing; products manufactured in these zones are exempt from Central Excise duties and other levies; all goods supplied to these zones from the rest of the country are treated as exports and are eligible for export benefits given to the supplier. In addition, complete tax holiday is given to units in these zones for a period of five years. Indians, non-resident Indians, persons of Indian origin and foreigners, can all invest in these zones. Foreign units with 100% foreign owned equity or joint ventures with majority foreign equity can be permitted in these zones. In KAFTZ, investments in purely trading and commercial activities is also permitted. Provisions which prohibit foreign investment in certain types of industries where foreign know-how and capital are not considered necessary, do not apply to KAFTZ. Free repatriation of profits and capital is allowed from these zones.

**Impact of Section 29**

FERA, 1973, and especially section 29, led to uncertainties in the climate of investment to begin with, but out of 877 FERA companies only Coca-Cola and IBM chose to move out. However, the unloading of shares by the FERA companies seems to have led to some unexpected and unintended results. *Far Eastern Economic Review* reported a
a scramble for shares of FERA companies by Indian businessmen abroad. The general modus operandi was to have a loyal local man, a foreign citizen, to incorporate a company abroad or to take majority shares in a foreign company which acts as a front organisation to buy the shares of the FERA company. The financing is done by the Indian businessman by over-invoicing and under-invoicing of imports and exports.

Another report in the *Far Eastern Economic Review* focussed on the tussle among business houses for control of these FERA companies. Many major business groups wanted the shares transferred en bloc while most of the companies opted for public issue of shares. They felt that once these houses got a toehold in the company, they would expand their control. Also, they did not want to let them into their executive management. Of course, the public issue did not guarantee that the big business houses would not get a hold but at least it made it harder.

The requirements of section 29 certainly brightened the capital market. The FERA companies, as they came to be called, were faced with the options (1) transfer the required shares to the Indian shareholders, or (2) issue new capital. Most of them were expected to complete the process of dilution of shareholding by the end of 1978. Many came out with public issues. But a large number of
them chose to allot a fixed number of shares to public financial institutions like the Unit Trust of India and Life Insurance Corporation of India. They felt that this would make the companies more secure against any drastic government action.

**Coca-Cola Case**

Coca-Cola Export Promotion Corporation, 100% American-owned, chose to wind up. It refused both, to dilute its equity holdings and to transfer its technical know-how to Indian bottlers. When notice was served to it under FERA, its headquarter in Atlanta, Georgia, responded with an offer— to reduce its equity in its Indian subsidiary to the level required, but insisted that it had to maintain an American-controlled liaison office to protect its trade secrets and to ensure the quality of the bottled drinks sold. These conditions were not acceptable to India, because they violated the guidelines set down for transfer of technology to India according to which technical know-how must be fully imparted to an Indian company which is to take over the foreign concern.

Coca-Cola understandably did not want to share its "concentrate" with others. It would be ruined in other countries all over the world. George Fernandes, the then Minister for Industries, illustrated Coca-Cola as a classic
example of a multinational operating in low priority but high profit area, stifling indigenous industry and causing an outflow of precious foreign exchange instead of inflow. A few years before Coca-Cola actually wound up, the government had been cutting back its import licences which are linked with export performance. Between 1958 and 1976, Coca-Cola said that it earned only Rs.111 million (about USS12.6 million) from exports. In 1977, the export sales were down to only Rs.180,000. The company was set up in India in 1950s with an investment of about Rs.660,000 in cash, machinery and plant. Bottling companies were set up by private Indian investors all over the country so that Coca-Cola captured 70% of the market. Between 1958 and 1974, it remitted Rs.68.7 million to US in foreign exchange through imports, profits, home office expenses and service charges. It applied to remit another Rs.36.9 million making a total of Rs.105 million. Its export earnings in the same period had been Rs.99.2 million so that there had been an outflow of foreign exchange. Such an outflow may be accepted with inevitability in high priority areas but not in low priority areas like Coca-Cola. This has been proved by subsequent development. The departure of Coca-Cola heralded a new era of growth in domestic soft-drink manufacturing.
IBM Case

The second foreign concern that wound up because of FERA was the US computer giant International Business Machines (IBM). It did not want the majority control of its marketing and maintenance to pass into Indian hands. Under FERA 1973, IBM was required to reduce its foreign equity holding from 100% to 40% by offering shares locally. But giving concessions to New Delhi might break its monopoly in other countries. IBM tried hard to retain its Indian connection. It suggested that any company importing an IBM machine should have the option to either choosing wholly owned IBM offshoot of some outside agency to carry out maintenance. The other compromise suggested was to split IBM India into two companies -- one of them with 100% IBM ownership carrying on export, marketing and maintenance, and the other, a 40% IBM holding in charge of the company's service bureaux which process data from clients who do not have their own computers. IBM also offered to support the growing technological development in India by setting up a research centre and a facility for assembling and testing integrated circuits cards and a measurement and analysis laboratory for electronic components. Both units were to be operated by government agencies. IBM also agreed to make selected IBM patents available to Indian organisations.
The offer was attractive but the Indian government insisted that requirements of FERA had to be met. It pointed out that the British-based International Computers Ltd., (ICL) had agreed to bring down its equity holding to 40%. While Coca-Cola is a low-priority consumer item, IBM is a major force in high technology field. Questions were raised about how far this action was in conformity with administration's avowed policy of foreign investment and collaboration in selected fields where foreign technology and know-how were needed. But the government pointed out that it had neither asked Coca-Cola nor IBM to go. All it had insisted upon was that requirements of FERA be met.

There were some important benefits derived from FERA. Many companies which were required to dilute their holdings diversified into other areas. WIMCO, a subsidiary of a Swedish Company manufacturing safety matches, for example, after dilution to 40% foreign equity diversified into manufacturing paper, chemicals, marine products, and processing of fruits and vegetables. It also began promoting projects to produce high quality seeds and seedlings for quick growing trees. The Indian Tobacco Company, which was once a subsidiary of British America Tobacco, was originally only manufacturing cigarettes but diversified
after dilution to production of paper, marine products and constructing a chain of luxury hotels. Hindustan Lever, still holding 51% of foreign equity diversified from soaps and vegetable oils to chemicals like phosphoric acid, caustic soda, pesticides, gelatine and others. Thus, by the application of FERA, 1973, the manufacturing was strengthened.

Legal Implications of Section 29 and Pivotal Role of Reserve Bank of India

Dilution of Equity Holding: The implications of dilution of equity holding came to the fore in the Needle Industries Case. In this case, the foreign shareholder tried to circumvent the dilution of equity provisions of FERA and, if that was not possible, to delay the dilution of its equity holding for as long as possible. While the Coca-Cola and IBM cases tested the political will to implement FERA, Needle Industries Case was a test case in court to see how strictly these provisions would be enforced by the judiciary.

Needle Industries (India) Ltd. (NIIL) was a company incorporated in India under the Indian Companies Act. It had been incorporated in July 1949 as a wholly-owned subsidiary of Needle Industries (India) Ltd., Studley, England (NI Studley). Since then a number of changes had taken place in the share ownership of the company so that by 1973
60% of NIIL was owned half by Coats and half by Newey. The remaining 40% were in Indian hands mainly with Devagnanam group.

With the coming of FERA into force on 1st January 1974, NIIL was required to bring down its non-resident interest from 60% to 40%. Some efforts at disinvestment were made but they did not succeed so it was decided at the meeting of Board of Directors to issue rights shares in order to dilute foreign equity holding. Rights shares means an issue of new shares by a company which are then offered on favourable terms to the existing shareholders of the company. At another meeting of the Board of Directors, the whole of the new issue of shares was allotted to the Indian shareholders. The majority went to the Devagnanam group. This led to the reduction of foreign shareholding to approximately 40% and an increase of Indian shareholding to about 60%. NIIL then sent a letter to the Reserve Bank informing it that the dilution of foreign equity holding had been done.

The Holding Co., in a petition in High Court alleged that the Indian directors had abused their fiduciary position in the company by issuing the shares at par and allotting the shares exclusively to Indian shareholders. They thus acted malafide in order to gain illegal advantage for
themselves. It was also alleged that Devagnanam deliberately delayed in sending to the Holding Company the proceedings of the meeting at which it was decided to issue shares at par; he also deliberately delayed in giving notice of the meeting in which the rights shares were to be allotted.

The Madras High Court upheld the contention as did the Division Bench on appeal. The Supreme Court, however, came to the conclusion that Devagnanam and his group had acted in the best interests of NIIL in the matter of issue of shares. They were under a legal compulsion to issue rights shares. In view of the provisions of section 29 of FERA, even if the offer of the rights shares was made to the Holding Company, it could not have been accepted by it. Further, the Holding Company also could not have renounced its portion of the shares in favour of any other person because the articles of association of the company negated the right of renunciation.

It was contended on behalf of the Holding Company that non-compliance with the condition regarding the dilution of non-resident interest within its stipulated period could not have resulted in the RBI directing NIIL to close down its business or not to carry on its business. It was also argued that non-compliance with conditions imposed
for permission to carry on its business would not have exposed the Indian directors to any penalties or liabilities and that there was no provision which gave RBI any power to revoke the permission once granted. Therefore, even if the conditions subject to which the permission was granted were not fulfilled, the business could not be made to close down. It was argued that closing down a business which the RBI had at first allowed would have serious consequences, public and private. Why no power had been given to RBI to require the business to be discontinued even if the conditions were not fulfilled. Where an application under section 29(4)(a) for permission to continue to hold shares was rejected, section 29(4)(c) enabled RBI to direct non-residents to sell their shares or cause them to be sold. This was the only power that RBI had where a condition imposed under section 29(2) was not fulfilled.

The Supreme Court felt itself unable to accept these contentions. The RBI gave permission to NIIL to carry on its business subject to certain conditions. Each of these conditions may not have been of the same rigour or importance, e.g. condition regarding submission of quarterly reports indicating the progress made in implementing the other conditions could reasonably be relaxed by condonation of late filing. But the dilution of non-resident
interest in the equity capital of the company to a level not exceeding 40% within a period of one year from the date of receipt of letter was the very essence of the matter. A permission granted subject to the condition that such dilution shall be affected would cease automatically on non-compliance with the condition at the end of the stipulated period or the extended period as the case may be.

If the Holding Company's arguments were accepted, the granting of a conditional permission would become an empty ritual. Whether or not the company performed the condition, it would still be free to carry on its business. It was argued that the only sanction available to RBI was that it could compel or cause the sale of the excess non-resident interest in the equity holding of the company under section 29(4)(c). This section, however, did not provide non-performance of conditions imposed under section 29(2)(c). Section 29(4)(c) provided for a situation in which an application for holding shares was rejected or was not made. If the conditions upon which permission to carry on business were not carried out, the only sanction could be that the business should not be allowed to continue.

Thus, unlike corporate giants like IBM and Coca-Cola, the foreign shareholder in the Needle Industries case tried
to see if it could circumvent the provisions of FERA. The decision of the Supreme Court indicates that the Court was determined to ensure strict compliance with FERA as the whole thrust of the Indian policy towards foreign direct investment was that the ownership should be kept as far as possible in Indian hands.

**Reasonable Opportunity to Make a Representation**

The provisions of FERA give very wide powers to the Reserve Bank of India as a regulatory body of foreign direct investment. In order to ensure that these powers are not abused, section 29 requires that no application can be rejected without giving the applicant a reasonable opportunity to represent.

In *Apeejay (P) Ltd., vs. Union of India*, the petitioner company entered into an agreement with Ludlow Jute Company Ltd., a non-resident company, to purchase its assets in India. According to the Agreement, Messrs. Ludlow were to work as caretaker for the petitioner company from 31st March, 1977, and the petitioner company was to get the requisite permission under FERA and any other rules and regulations in force.

The Reserve Bank of India directed the petitioner to take clearance from the Government of India for the
proposal of Messrs. Ludlow to transfer their business to Apejay (P) Ltd. The Government, on application, did not approve the Agreement.

According to Section 29(2)(c) of FERA, 1973, before any application for permission is rejected by the Reserve Bank, the applicant must be given a reasonable opportunity to make a representation. In this case, the Calcutta High Court held that the Reserve Bank had failed to exercise its powers because it had referred the parties to the Central Government so that, in effect, the Central Government had usurped the powers to be exercised by the Reserve Bank. Further, the Government had given no reasons for rejection which must be given under section 29 to enable the parties to make their representations. The applicant could challenge the decision on grounds that no reasons had been recorded; or that the reasons given were irrelevant, or were coloured by policy or expediency. The approval or rejection of an application did not, therefore, depend on the subjective satisfaction or otherwise of the authorities, but on an objective consideration taking into account all aspects of the case. Hence, the Calcutta High Court set aside the decision.
The Needle Industries Case and the Apeejay Case established the Reserve Bank of India as the chief regulator of foreign direct investment in India. The Supreme Court in its interpretation of section 29 in these two cases also indicated a determination to ensure strict compliance with its provisions. In the Swraj Paul Case the question arose at what point of time was the foreign investor required to take the permission of the Reserve Bank; before the purchase or after the purchase of shares.

Swraj Paul, a business magnate of Indian origin stationed in London, bought shares in the names of thirteen foreign companies of Escorts (7.29% of the paid up capital) and 1,040,000 DCM shares (12.95% of the company's paid up capital) in March 1983 through R.B. & Co., stockbrokers. The aim seems to have been to take control of these two companies. The applications for permission to purchase of these shares under section 29 of FERA were received by the Reserve Bank after the shares had been purchased in March, but the permission to do so had not been obtained even by August 1983. The permission was only obtained on September 18, 1983. The Directors of Escorts refused to transfer the shares in June 1983. On obtaining the permission from the Reserve Bank of India, R.B. & Co.
requested the board of directors of Escorts to reconsider their refusal to register the shares. Life Insurance Corporation (LIC), a public financial institution, the majority shareholder in Escorts, tried its best to persuade the directors of Escorts to transfer the shares to Swraj Paul. When it failed, it resorted to requisitioning an extra-ordinary general meeting (EGM) of Escorts for what the Bombay High Court in a judgement delivered on November 9, 1984, called a "collateral purpose", namely, to use its voting strength to oust nine of the fifteen directors and to replace them with nominees of financial institutions. This, the court said, amounted to taking over the company which the LIC could not do. Under its Act, it could only act to protect its own investments which were in no danger, or to prevent the company from doing anything against public policy. The court upheld the right of the Board of Directors not to register transfer of shares to Swraj Paul and it held as illegal the removal of 9 part-time Escorts Directors at the instance of the Life Insurance Corporation.

The Bombay High Court also held that under section 29(1)(b) of FERA it was mandatory for a non-resident investor to get prior permission of the Reserve Bank for the purchase of shares in an Indian company. Hence, Escorts
were prohibited from registering the transfer of the shares in question and were justified in law in refusing registration of the transfer of those shares. The Times of India of November 12, 1984, found in Bombay High Court's judgement a stern indictment of government's brazen bid to promote a take-over of Escorts and of DCM by the Capro group of companies controlled by Mr. Swraj Paul.

The Supreme Court, in its judgement of December 19, 1985, set aside the judgement of the Bombay High Court.\textsuperscript{71} The Supreme Court held that the permission of the Reserve Bank of India required by section 29 of FERA could be \textit{ex-post facto} and conditional. Also, that foreign companies whose more than 60% shares were owned by persons of Indian nationality or origin could avail of the facilities under investment schemes for non-resident Indians even if the same group of shareholders figured in the different companies. The Court further held that the Reserve Bank of India was not guilty of any \textit{mala fides} in granting permission to Swraj Paul's Caparo Group of Companies. It was also not guilty of not applying its mind in granting permission. The Union Government, too, was absolved of \textit{mala fides}.

Thus, the Supreme Court once again established the Reserve Bank of India as the main regulatory agency of
foreign direct investment under FERA. Its decisions could not be lightly overruled. This judgement of the Supreme Court is an attempt to create stability in investment environment. Otherwise, companies would be tempted to fight their corporate battles in the court using provisions of FERA which could lead to an uncertain investment climate. Whereas in the Needle Industries case the Supreme Court had shown a determination to ensure compliance of the foreign investor was not thwarted by the Indian business, the provisions of FERA could not be used by the Indian investor to prevent the entry of the foreign investor.

Conclusions

In India, foreign investment has been mainly looked upon as a vehicle for transfer of technology required by the country. The technology is needed to develop the industrial base of the country in order to make less dependent on external resources and become more self-reliant. That foreign investment is regarded as an important means of achieving this objective is evident by the fact that more than 7,000 foreign companies have entered into collaboration agreements with Indian firms for investment and transfer of technology since 1957. FERA, 1973, has encouraged collaboration as opposed to the establishment of subsidiaries and branches of foreign
firms. By ordinarily limiting the foreign equity in a joint venture to forty per cent, it has sought to achieve the policy objectives of the Government of India. It has given Indians an equitable share in the profits. It has also given them an effective say in the management and control of the investment while it has at the same time made the foreign investor more aware and responsive to the national economic policies and aspirations. Further, it has led, as we have seen, to expansion and diversification and thus to the strengthening of industry in India.

Initially, FERA 1973, acquired some notoriety chiefly because the existing foreign companies were required to dilute their equity holdings and because of the Coca-Cola and IBM cases. But the figures show that FERA 1973, has not been an unduly major hurdle in way of foreign investment. The number of foreign companies which have entered into agreement with Indian firms during the last five years has increased as can be seen from the following table:  

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<td>1981</td>
<td>389</td>
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<td>1982</td>
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Thus we can say that FERA has not been unduly restrictive.
Further, the approach of the government has not been rigid. A higher percentage of equity has been allowed in sophisticated high technology areas and in export-oriented industries. In case 100% export-oriented companies, even 100% foreign equity can be allowed. Investment schemes like those for OED countries and non-resident Indians together with the establishment of free trade zones with liberal investment facilities show an effort to raise foreign capital without losing sight of policy objectives.

The encouragement of the collaboration pattern as opposed to the subsidiary pattern has also made these ventures act as catalysts to the development of local enterprise. Collaboration can be in the form of one-time purchase of know-how where the drawings and specifications are handed over to the local nationals for a fee. It also involves some training for the locals. It is, then, upto the local nationals to develop their industry as rapidly as possible so as to reduce their dependence on the supply of foreign components. If this development is slow, the foreign party benefits because it can charge monopoly price for the components. The collaboration pattern has the advantage that the local manufacturer tries to develop alternate indigenous sources of supply instead of paying the price demanded. The product so developed may not come to world standards for a time but if there is a large enough domestic
market to support the local manufacturer even if his prices are high, together with pressure from the government for rapid import substitution, the indigenous alternative develops. Both these factors are present in India and hence the development of indigenous industry.

Collaboration can also be through equity participation which implies an on-going relationship between the foreign investor and the local investor. The interest of the foreign investor is in the profits and if there is a large enough domestic market as there is in India, the foreign investor is more likely to diversity than to repatriate and pull out. India, as we have seen, has a large domestic market and investment is profitable. When there is an insistence on reducing the equity holding as under section 29 of FERA, the foreign investor is willing to do so and diversify because his returns are high.

Of course, the FERA pattern is not perfect. It has often been pointed out that in joint collaborations there are chances of collusion between the multinational corporation and its local partner. When such a collusion takes place the local partner may not be willing to develop substitutes because initially these substitutes are costlier and it takes a lot of effort to develop them. The foreign investor also tries to ensure that such a substitution
does not take place by rejecting the local product on grounds of quality or by supplying its own components close to marginal costs. This, of course, suits the local manufacturer. Counter-pressures develop because other local manufacturers develop the substitute and clamour for government protection which in India, is usually provided. Thus, opposing interest groups are created.

Multinationals can play a positive role in economic development through import substitution if the foreign exchange so saved can be used for the development of industrial infrastructure. Growth in such a case is initially slower than if multinationals were allowed free entry but it is also a question of foregoing growth in the present for the future balanced growth. It is possible to follow this collaboration pattern in India because of a sizeable domestic market which insulates the manufacturer from immediate pressure to export.

It has also been argued that shortages of foreign exchange have sometimes led Indian companies to import plant and equipment of obsolete design. The contention is that if subsidiaries of multinationals had been involved technology might have been more modern and production more rapid. But then there may not have developed the healthy
self-confidence to absorb foreign know-how and improvise where necessary within the framework of existing indigenous facilities.
Chapter IV

CANADA AND FOREIGN INVESTMENT

Factors shaping Canada's Foreign Investment Policy

Canada, being basically a resource based country with a large US investment which is of fundamental importance to its economy, shares some of the concerns of developing countries due to a basic sense of insecurity vis-a-vis USA, which is a friendly but a much larger and more powerful neighbour. Over and over again, the fear has been expressed that since non-resident control is centred mainly in one country, namely, the US, the Canadian economy will gradually become so integrated with US economy that it might eventually lead to economic domination and even loss of political independence. Canada has also been concerned with costs like depletion of its natural resources; biases introduced in the industrial development; truncation of industries and their stunted growth; transfer pricing; external influences on public policy like export and import restrictions on subsidiaries and extra-territorial extension of US laws in Canada. The effort has been to reap the benefits of US investment, minimize the costs, and at the same time, maintain an independent identity.
Development of Economy in Canada

Canada's economic development has taken place primarily through foreign investment. Major projects like the building of St. Lawrence Canal System, construction of railways all took place with the help of foreign capital. Initially, investment was portfolio investment. Before 1900, capital was mainly imported from Great Britain. After 1900 more and more investment came from USA and in the form of new direct investment. Great Britain still remained the largest supplier of portfolio debt. Between 1910 and 1926, however, the roles changed and by 1926, most of portfolio investment in Canada was from USA. After 1945, countries other than Great Britain and USA also invested in Canada, but the major investment remains from the USA.

Foreign direct investment grew from $2.7 billion or about 40% of foreign long-term investment in 1945 to $15.9 billion or about 60% of foreign long-term investment in 1964. Of this, US accounted for 12.9 billion or 80%, while UK for an additional $1.9 billion or 12%.

Foreign ownership and control of corporations located in Canada is concentrated in manufacturing petroleum and natural gas, and mining and smelting. Foreign ownership of Canadian manufacturing increased substantially from 38% in 1926 to 54% in 1963 and foreign control increased even more from 35% in 1926 to 60% in 1963.
Foreign ownership and control of mining and smelting expanded from 37% in 1926 and 62% in 1963 in the case of ownership and from 37% to 59% in the same period for control. In addition substantial petroleum and natural gas industry has developed and has absorbed large amount of foreign capital. In 1963, oil and natural gas industry was 64% foreign owned and 74% foreign controlled. Ownership and control by US residents increased substantially since 1926. US ownership of the above industries rose from 19% to 28% while ownership by other non-residents fell from 18% to 7%. The control increased from 15% to 27% while control by other non-residents rose from 2% to 7%.

Within the manufacturing sector there were certain industries where foreign control was very high and in all such cases ownership was mainly by US residents. In 1963 foreigners controlled 97% of the capital employed in the manufacture of automobiles and parts, 97% in rubber, 75% in chemicals and 77% in electrical apparatus. The corresponding figures for US control were 97%, 54% and 66%.

Not only was foreign equity capital concentrated in certain industries, but it was also concentrated in large corporations. In 1963, there were 414 corporations with assets greater than $25 million each and with assets totalling $37.0 billion. Of this, $19.9 billion or 53%
of the total were in firms which were more than 50% owned by non-residents. In firms with assets of less than $25 million, $10.7 billion or only 32% of the total $34.0 billion of assets in these firms were in firms more than 50% owned by non-residents. Therefore, more non-resident investment was in large corporations, which, because of their size, could exercise great economic power and control the market.  

Benefits and Costs

The benefits of foreign direct investment have been indisputable to the Canadian economy. Foreign direct investment was accompanied by flow of technology and entrepreneurship. It increased production which in turn led to new investment, domestic and foreign. This led to an addition to Canadian income and part of that increase went to labour. Indirectly, the Canadian economy benefited by technological transfer which later became available to domestic entrepreneurs. But direct foreign investment imposed costs on Canadian economy. The major part of US direct investment was in manufacturing firms.

Often, US direct investment occurred because there was a relatively high rate of growth in a particular sector of the economy -- to begin with exploitation of natural resources. In the 1890s there was a large amount of American investment in mining companies because of the rapid rate of growth of output in the newly discovered mines.
Between October and December 1895, 35 US Mining companies were formed compared to 52 Canadian companies. When American firms were created in Canada for exploitation of natural resources, they were often responding to simple economic stimuli of obtaining natural resources at lower costs and ensuring their steady supply by controlling them. These companies did not seem to recognize any other international boundaries except for barriers to trade like exchange rates and tariffs. This had its own consequences. For example, there could be a mining company in Canada, but its main refining capacity would remain in USA. This happened in the case of International Nickel Company which sprang from the merger of two firms operating in Canada. Their refinery was located in New Jersey. This was because their initial refinery was already located there. The only other major company in the copper-nickel industry was British and its refinery capacity was located in Great Britain. This frustrated attempts to stimulate large manufacturing capacity. Further, since expansion into Canadian resource sectors was often based on an attempt to control resources and thereby to ensure a flow of them to an industry in US at relatively low and stable prices, there was no reason for these firms to develop large manufacturing in Canada.
Even when manufacturing develops large foreign control over manufacturing industries can lead to certain biases. When the parent company, for example, is located elsewhere, it is usually the parent company that undertakes research and development. While it may be more efficient for the economy as a whole to import new technology through multinationals, it is necessary to develop one's own research and technology because when neither the parent company nor the branch is domestically controlled, if for some reason the new technology is not readily available, the emergence of high-tech industries can be dampened. It can also lead to "brain-drain", that is, skilled scientists and technocrats can move out of the country to other countries where there are better research facilities.

Also, when one country becomes a major investor in another country, the two economies get inextricably tied together, the case, for example, of Canada and USA and this is bound to affect the smaller economy. The US tariffs, for example, had a great influence on Canadian industry. They were very low for industrial materials in their raw form or in an early stage of processing and became progressively higher on goods at a more advanced stage of manufacture. The result was that Canada could not produce fine paper economically and export it to USA; base metals, too, could not be sent in a more highly refined
or fabricated form to US; and Canada could not compete in the US markets with some of the chemicals that could be produced from oil and natural gas. There was, thus a stunting effect of the US tariffs on Canadian industry.

Again, in the 1960s forced repatriation of dividends placed a strain on Canada's economy which was directly related to Canada's foreign indebtedness. When in addition there is portfolio investment, too, the interest payments have also to be made no matter what the state of economy.

The third problem is the loss of tax revenue which may occur because of the presence of a large number of subsidiaries, especially from one country so that it becomes difficult to take regulatory action. The subsidiaries sell to other subsidiaries or to the parent across the national boundary. Multinationals pay tax on their profits in Canada but by transfer pricing or manipulating the cost of services provided, profits can be transferred to places where corporate profits tax rate is lower, that is to tax havens. The larger and more diversified the multinational investment, the more can be lost in taxes, so that the economy suffers and control is also lost.

The last cost and the most difficult to articulate is perceived as loss of sovereignty over public policy, that is, the ability to take decisions in national interest unhampered by the influence of another country. The United
States openly accepts through legislation like the Trading with the Enemy Act that it has extraterritorial power over US-owned companies and elsewhere and that these companies are required in their activities to conform to US law. The Act is believed to have forced many US-controlled companies to forego potential export sales to many countries with whom Canada has full and cordial diplomatic relations. Similarly, exports of certain goods which contain a high-tech component is prohibited to certain countries. It is difficult to quantify the monetary loss in such cases, but it can be politically rather embarrassing for the host government. Further, another aspect of the same problem is that economic integration often leads to cultural integration, especially in a case like Canada and USA where social and cultural institutions, language and religious beliefs are already similar, and where USA is far more dominant than Canada.

Predecessors of FIRA

The Royal Commission on Canada's Economic Prospects chaired by Walter Gordon, which was constituted in 1955 and tabled its report in late 1957, first brought to the notice of the Canadian people the degree of foreign control over Canadian economy and its consequent costs. Subsequent studies intensified the public concern. The result was that both federal and provincial governments tried to regulate and monitor the non-resident-controlled firms.
The idea was to prevent the increase in foreign concentration rather than to force its decline. The result was legislation by which key sector industries were to be kept in Canadian hands.

The Watkins Report, 1968, provided a fresh analysis of foreign operations in Canada and launched a new era of Canadian economic nationalism. It showed a great concern for the extra-territorial effect of US laws being transmitted to Canada through the multinationals and their discouragement of greater Canadian entrepreneurship. It also questioned whether foreign investors could not be required to guarantee greater benefits to the host country's national economy. The report recommended establishment of Canada Development Corporation to buy equity in and thus repatriate Canadian business so that Canadian management skills could be improved: local R&D could be increased and export expanded. This was to be coupled with the creation of an agency to survey and screen investments and operations of multinationals in Canada. As a result Canada Development Corporation was established in 1971.

The Wahn Report in 1970 built on the Watkins Report and was more radical. It called for an eventual transfer to Canadian majority ownership of all firms operating in Canada, majority Canadian representation on all corporate boards of directors, limitations on foreign borrowing in Canadian market, appointment of government trustee to exercise voting rights of foreign-owned shares of any
company affected by extra-territorial assertions of foreign law. New guidelines were issued by Department of Energy, Mines and Resources concerning new equity participation by foreign investors in both resource exploitation and the processing in Canada of primary products.

In March 1970, the government assigned Herbert Gray, the task of bringing forward proposals on foreign investment policy for its consideration. A working group was set up to prepare background material to assist. Its report was published in 1972, but it was asserted that it was not a statement of government policy nor did the government endorse all aspects of the analysis contained in it. The report recommended a mechanism of foreign investment screening agency; found the 'key sector' approach useful, but not flexible enough; the fixed-rule approach requiring Canadianization of a percentage of equity insufficient assurance that the Canadian point of view would be respected and to involve unjustifiable costs. It favoured scrutiny of all foreign takeovers of Canadian firms and of all new investments as well as of unrelated expansion of foreign controlled companies established in Canada. It also favoured screening of licensing arrangements, joint venture agreements and management contracts between Canadian and foreign firms.
The object was to ensure that new investment would enter Canada only on terms favourable to Canada. In reviewing the following factors were to be taken into consideration: nature of the investor's product line; relationship of the subsidiary to the parent company and to its international affiliates; technology to be employed; plans for R&D; source of raw materials and components; Canadianization of personnel, managers and the directors; capital structure and sources of financing; and degree of processing of primary products. These factors had to be seen in the context of contribution to productivity and industrial efficiency of the proposed investment; its compatibility with government's industrial policy; its contribution to national level of economic activity and employment; its geographical location in Canada and its competitive impact.

Foreign Investment Review Act, 1973-74

Foreign Investment Review Act was fathered by the Gray Report. It was not simply a matter of eliminating the perceived costs of foreign investment. If foreign investment only resulted in costs to the economy it "could be simply blocked" but it was recognized that it had "in the past played, and continues to play an important role in Canada's economic development." Therefore, the benefits had to be enhanced and costs minimized.
Further, the costs and benefits had to be considered not in general but with reference to each individual case to ensure that the particular investment would bring benefits to Canada. While approving a particular investment, the authorities were supposed to "negotiate" with the foreign firms "to improve net benefits from proposed foreign direct investment". But the Gray Report recognized, that a comprehensive intervention was not possible "on grounds of both economic policy and administrative feasibility". Thus, only a selective intervention was recommended based on the "economic significance" of the investment. It was also emphasized that "general policy instruments" had to be evolved and the approach ought to be flexible, keeping in mind that very definite benefits came from foreign direct investment. Thus, Canada should not be closed off from "new developments in technology and management elsewhere" and from "access to some foreign markets for certain products."

The Act itself was fairly moderate in that it did not apply to existing foreign business in Canada and its expansion into related activity or to its reinvestment of profits into related activity. This is a major source of foreign direct investment. It also did not prevent foreign business from buying into other businesses in Canada as long as this did not result in acquisition of control over businesses.
Even if a foreign business wanted to start a new business in Canada; or expand into unrelated business in Canada; or acquire control over another business in Canada, it was not prohibited from doing so. It had to give notice to that effect and undergo a review process in order to ensure that its activity resulted in significant benefit to Canada. Investors, chiefly American investors, found some problems with Act.

**Difficulties caused by FIRA Negotiating Process**

USA complained to GATT panel in 1982 that the FIRA agency in Canada, in its negotiating role, was making investors sign legally enforceable undertakings like buying Canadian goods, exporting a specific amount of their production, or not distributing some of their products in Canada which resulted in severe restrictions on trade. The US position was that imposing such conditions violated Article III and Article XXIII of GATT. Article III(4) provides for national treatment to products imported from the territory of a contracting party. The American argument was that the local content requirements of which the foreign investors were almost made to commit themselves violated Article III because the products of domestic producers were thereby favoured.
Alternatively, even if Article III or any other specific provision of GATT was not violated, under Article XXIII\textsuperscript{23} members could complain against measures which had the effect of "nullifying" or "impairing" any treaty benefit. It was alleged that commitments made by non-Canadian investors under FIRA could undermine benefits which the US expected to receive after tariff concessions were negotiated under the treaty.

Further, the American argument was that by requiring an American corporation in Canada to increase its exports and decrease its imports, it reduced US exports to Canada and increased US imports from Canada which was detrimental to USA. Also, if such policies were left unchallenged, they would serve as precedents for other nations particularly the less developed countries thus having a detrimental effect on American investment throughout the world.

The Americans also argued that such undertaking contravened Article II\textsuperscript{24} of the OECD agreed upon by the governments of member-countries. The answer to that was that the Declaration was only a political and not a legal document and, therefore, its contravention could bring no legal sanctions. Further, in view of the extraordinary high level foreign ownership and control in Canada,
Canada had made reservations before accepting the Declaration by which it had "continued to retain its right to take measures affecting foreign investors."\textsuperscript{25}

The GATT panel ruled that the undertakings being taken from foreign investors by the FIRA Agency was against the provisions of GATT. This was a victory for the US in its efforts to prompt the relaxation of FIRA requirement. At the same time, the panel ruled in favour of Canada when it did not find any violation of the GATT provisions in requiring foreign investors to undertake to increase their exports from their Canadian operations.

**Extra-territorial implications of FIRA**

The American feeling was that their business was being treated unfairly because of extra-territorial application of FIRA. This came to the fore in the Dow Jones case.\textsuperscript{26} Dow Jones & Co. Inc. was a publicly-held US concern engaged in diverse communication activities. Richard D. Irwin (Irwin-US), also a US Corporation, was a major book publisher and Irwin-Dorsey Ltd. was its wholly-owned Canadian subsidiary. Dow Jones, which had acquired a substantial interest in Irwin-US, decided to acquire it. As a step in that direction, Dow Jones incorporated RDI Inc., a US corporation as its wholly owned subsidiary. In 1975, Dow Jones caused RDI to merge with Irwin-US. As a result of the merger RDI acquired Irwin-Dorsey and Irwin-US ceased to exist as a corporate entity.
The purpose of structuring the transaction as a merger of Irwin-US and RDI was to enable the shareholders of Irwin-US to exchange their stock on a tax-free basis for shares of Dow Jones and not avoid the FIRA review.

Since the merger came ostensibly within the scope of FIRA, Dow Jones submitted its investment proposal to the agency but reserved for itself the right to contest FIRA's jurisdiction to review it. The Agency refused to approve the transaction in both 1975 and 1978 claiming that it failed to pass the significant benefit test. Dow Jones sued in the trial division of the Federal Court of Canada contesting FIRA's jurisdiction to review the transaction.

The trial court held that the agency had the jurisdiction to review the transaction. The appellate division, on appeal by Dow Jones, upheld the decision of the trial court. Dow Jones then appealed to the Supreme Court of Canada which refused to hear the case.

The issue raised in the Dow Jones case that FIRA could not act extra-territorially as that would be a violation of international law was skirted by the court when it said that FIRA only purported to regulate the acquisition of Irwin-Dorsey by Dow Jones and not the merger of Irwin-US and RDI. Thus, the court ruled that the Act did not have an extra-territorial application in this case. In dicta, the court indicated that even if
an extra-territorial application was involved, the Act would still be valid because the Parliament could enact legislation which had an extra-territorial effect. However, by focussing on the particular case of Irwin-Dorsey, the court avoided examining the international law issue raised by Dow Jones.

The Dow Jones case reflected the feeling among the US businesses that they were being treated unfairly by the extra-territorial operation of FIRA. As one commentator put it. "[t]his is precisely the kind of interference which the Canadian Government would resent were a foreign government to attempt to legislate in what would be regarded as a domestic transaction in Canada." 27

**Significant Benefit Criterion**

The Act was further criticised because the investors felt that the standard for determining whether an investment would be of significant benefit to Canada or not was vague. This hindered the negotiating process and made it more difficult. 28 The Commissioners of FIRA pointed out that investors were more likely to agree to undertakings if they understood that these undertakings were required in consonance with clearly enunciated industrial policies. In the absence of such an enunciation, the screening process appeared totally arbitrary
The problem was compounded by the fact that the majority of the guidelines were internal to the government. That is, the FIRA officials had the guidelines while the investor who was expected to follow them did not.

Reviewable Investments

To make matters worse, it was not always clear whether a particular investment was reviewable or not. Many potential investors approached the agency to find out if their planned investment would be reviewable under the Act or not. The agency gave an opinion but as this opinion had no legal binding it could act only as a guideline under section. Under section 4(1) it was only the Minister who could give a legally binding opinion on whether an investor was a "non-eligible person" or whether a transaction was reviewable. The opinion was binding on the Minister for two years provided all material facts had been disclosed at the time of the giving of the opinion and remained unchanged for that period of two years. Hence even if the agency said that a particular transaction was not reviewable, the Minister was not bound by that opinion and this created unnecessary uncertainty.

Delays

The situation was further aggravated by the length of time it took to get a decision. Section 13 of FIRA provided for deemed approval if no decision was taken by the Minister and cabinet within sixty days.
But the Minister did not necessarily have to come to a decision within those sixty days. He could inform the applicant by notice in writing that the applicant had the right to submit "such representations in connection with the matter has he or they see fit." Thus, instead of automatic approval, such a notice was sent and then the review period could be prolonged indefinitely.

The concerned parties blamed each other for the delay. The agency blamed the applicants for being very slow and unwilling to provide the required information while the investors felt that the agency was too demanding and fulfilling those demands was too time-consuming especially when the statutory criteria of "significant benefit" were vague so that they did not really know what was expected of them. The agency felt that other causes of delay were that the provincial governments and federal departments were too slow in giving their opinions on the proposed investment which the agency was statutorily required to take into account making its assessment. Finally, "third party" representations caused delay.
Third-party Representations

Secrecy provisions forbade the agency to disclose the name of the applicant or the Canadian business proposed to be acquired. Hence, third-party representations were usually the result of rumours heard by a competitor or employee groups. The representations could also be by members of parliament relaying a concern from a constituent. Secrecy provisions also made it difficult to get relevant informations in response to these representations because the agency could not even reveal that a particular application was being reviewed. Further, the applicant could not respond to the questions raised and clarify them because he was not aware of their existence.

Unwieldiness of the Process

The final decision was to be made by the Cabinet. Considering that about eight hundred cases a year had to be dealt with, it was a time-consuming process for the Minister as well as for the Cabinet. As has been pointed out, it worked out to about sixteen cases per week for the Cabinet out of which at least four required detailed discussion. Since each case had to be decided individually, it left little time for evolving policy guidelines.
Confidentiality

If an application was disallowed, no reasons were given. All that was said was that the application had failed to meet the significant benefit test. The statute gave the discretion to the Minister to give information on undertakings except where the Minister felt that such a disclosure would not serve any purpose with respect to the administration of the Act and would prejudicially affect the applicant in his business. Since there was very little information disclosed, a new applicant had no precedents to guide him and the evaluation of the effectiveness of the Act became difficult.

Compliance with the Act

Under section 15, the Minister could order investigations to find out whether the terms and conditions crucial to the approval of the investment were being respected. Of course, it was conceded even in the Gray Report that an investor could not be held responsible for non-compliance if the market conditions changed. But the Minister seemed to have unlimited discretion in determining whether the market conditions had changed. It was also not clear that upon such a determination, if the Minister decided to modify the terms of agreement, whether he had to take fresh cabinet approval. These two factors combined with the confidentiality surrounding the whole process made it difficult to evaluate how faithfully the
the Act was being complied with by the investor and by the designated Minister and the cabinet.

Other Problems

Finally, US investors claimed that since FIRA was applicable to a company's extension into an unrelated area of business, they felt inhibited in diversifying and improving the profitability of their undertakings.  

FIRA to Investment Canada

In view of the difficulties faced by the investors, the government showed a willingness to streamline procedures. The notes accompanying Mr. Gray's letter to the Canadian Bar Association indicated that guidelines could be issued on a "regular industry sector basis to indicate the manner in which the cabinet or Review Agency is interpreting the significant benefit criteria in the light of changing economic conditions and government policy" although it was pointed out, that these guidelines could not really deal with all the different facts present in different proposals even within the same industry like the state of business being acquired, the impact on competition, the impact on technological advancement and others. The notes said that whenever the Act was amended, a pre-notification procedure could be provided for and interpretation notes
could be issued regularly to solve problems of interpretation.\textsuperscript{36}

In June 1982, the threshold for review for new investment or direct acquisition in Canada, under the Small Business Procedure was raised from 2 million dollars in gross assets and 100 employees to 5 million dollars and 200 employees.\textsuperscript{37} Further, if a foreign-controlled Canadian company was acquired because of the acquisition of its parent or of another foreign controlled company, then the threshold for review under Small Business Procedure would be 15 million dollars in gross assets and 600 employees.\textsuperscript{38} The small business investments were not be subjected to full review procedure, unless they raised important policy issues. Only the "key elements of the investment proposal" were to be examined. The internal decision-making process even in the case of full review procedure was to be simplified.\textsuperscript{39}

On August 23, 1982, three further measures were announced by Mr. Gray to streamline procedures:

1. the issuance of interpretation notes covering certain legal issues;

2. the institution of a formal policy on the provision of opinions by Foreign Investment Review Agency on legal questions concerning the application of the Act; and

3. the introduction of changes to the Regulations and the forms for filing notice.\textsuperscript{40}
Finally, in October 1982, Mr. Gray was replaced by Mr. Lumley as Minister of Industry, Trade and Commerce and the Minister responsible for FIRA. The Commissioner of Foreign Investment Review Agency was also changed. These moves were an attempt to reassure investors that Canada was a "safe place to do business"; that it was "safe to expand and modernize."^41

While the government showed a willingness to streamline procedures, there was no move to reform the statutory framework. Even the Canadian Bar Association, while criticizing FIRA, had a few positive things to say about it. It accepted that the Review Agency had ensured that foreign investment conformed to the economic policy objectives of both the federal and the provincial governments. Because of the Agency's involvement international product mandates had been secured for Canadian made goods and services; the amount spent on research and development had been increased; Canadian-owned technology had improved; there was increased Canadian participation in management and ownership; and new supplier industries and consultative services had been established.\(^42\) Therefore, the Canadian Bar Association did not recommend the abolition of the Act but a change of approach which would project the "significant
benefit criteria" as "positive factors which, if met will enable foreign investors to be more successful in Canada .... foreign investment review must be a positive experience." 43

To make the experience a positive one, the Canadian Bar Association recommended several changes in the investment review law. The most important were issuance of guidelines on industry sector basis to indicate how the significant benefit test would be applied while at the same time, keeping a flexible approach.44 A pre-notification procedure was recommended to apply to all new businesses and take-over notices below meaningful threshold level. The threshold levels were to sharply increase so that only the important investments came under the review procedure and thus could be thoroughly reviewed. 45 Emphasis was placed on increasing the information flow so that applicants would know the government policies, the status of their application, the time it would take to get a decision and the agency's disposition towards them. 46 Third party interventions were either to be eliminated or if allowed, then a system was required whereby the applicant could also respond to them. 47 Finally, it was felt that emphasis should not be so much on ownership as on evolving methods for greater Canadian participation.
The change of attitude and mood is reflected in the report of the Macdonald Commission which recommends liberalization of laws pertaining to foreign investment in spite of accepting that there is a rather high degree of non-resident control over Canadian economy and sees free trade with USA as a means of encouraging investment both domestic and American. The point of view expressed in the Macdonald Commission Report has been repudiated by the Other Macdonald Report. In reality, it is the old debate of "nationalism" versus "continentalism." It is only a question of which side is dominant because of pragmatic economic realities.

According to the figures in the Macdonald Commission report, in 1982 foreign companies held 49% control in Canadian manufacturing, 45% in petroleum and natural gas, 43% in mining and smelting; and 26% in all other industries including agriculture and finance. Firms controlled in the United States owned most of these large foreign holdings and accounted for about 80% of the foreign direct investment in Canada. The Commission accepted that few other economies, apart from those of Australia, Belgium and Ireland, had as much as 40% of their manufacturing capital in companies owned by non-residents. Italy, France, West Germany and the United
Kingdom had about 20% to 30% of their economies foreign owned; Sweden and Norway about 10%, and the United States and Japan about 5%.

However, the Commissioners pointed out, the inward flow of foreign direct investment had decreased from the 1960s. Canada's share of global direct investment had fallen from 16% in the early 1960s to 3% in the late 1970s and then to a negative figure in the early 1980s. In spite of that Canada's stock of foreign investment remains high because of reinvestment of profits by foreign controlled companies. Therefore, foreign multinational would continue to play an important role in Canada's economy.

As the Report points out, substantial benefits accrue from inward capital flows and these benefits are likely to increase in future. The Canadian Government especially gains considerable revenue by taxing gains which can be attributed to foreign investment: between 1.5% and 2.5% of the gross national product. Even more important, foreign investment is seen as a major vehicle for valuable technology, managerial know-how and entrepreneurship. It is recognized that Canadian policies should not impede the flow of these elements. When a foreign investor has
equity ownership in an enterprise, it provides an incentive to apply the ideas and processes in that enterprise. Licensing is not as efficient because the licence fee is much higher and the innovator is tempted to take his ideas to countries where he can get more advantageous terms.

The Report tries to repudiate the arguments of those favouring more stringent control over foreign investment. For example, there is the argument that multinational following a global strategy do not conduct as many managerial and research activities as comparable Canadian controlled businesses; that they import more than they export; and that some subsidiaries are established only to serve the domestic market which leads to truncation because the subsidiaries do not try to break out of the relatively small domestic market to compete in the world market. The report points out that there is little evidence to show that extensive foreign control leads to these deficiencies in industry. While the domestically controlled firms may spend more on research and development, but the productivity of foreign-controlled firms was more. Again, the foreign controlled firms may be importing more because suitable "inputs" or components may not be available in Canada or may not be competitive in price or quality with imports. Besides, truncation resulted from the National Policy of 1879, the relatively small size of the domestic market and the tariff
and non-tariff barriers created by the trading partners of Canada. Hence, it could not be said that the above-mentioned deficiencies were because of extensive foreign control.

Again, another argument against foreign controlled firms is that it is difficult for the host government to control them since they are more likely to be responsive to the policies of the home government. The Canadian controlled firms are likely to be more responsive to measures taken by the government to preserve cultural autonomy and preserve national security. American tax policies affect decisions of American-owned firms in Canada. For example, American tax laws encourage multinationals to repatriate their earnings and to expand at home. Also, US-owned subsidiaries have often had to choose between competing policy demands of the two national governments. Besides, disputes have arisen on trade restrictions imposed by the US government on their subsidiaries for national security reasons; and on the attempted extra-territorial application of US anti-trust and other regulatory laws.
The third argument for regulating foreign investment is that foreign multinationals often restrict the authority of their subsidiaries to export or to export with innovative techniques. But, the Commission finds little evidence to support this claim in Canada. Besides, it is difficult to determine the motivation of the management in many situations. There is some evidence that foreign controlled firms in manufacturing and natural resource sectors tend to favour established suppliers in their home countries over Canadian firms offering goods of comparable quality at competitive prices. Similarly, managers of multinationals may resist giving the Canadian subsidiaries a world product mandate that is, the mandate to produce particular products as the sole corporate source of supply for world markets, because they want to maintain control over all aspects of the management of the subsidiaries. Since these potential conflicts do exist, some form of government regulation is recommended. But the report emphasizes that the extent of government intervention that is there in Foreign Investment Regulation Act is not required. Hence Investment Canada Act is favoured.

The Commission also believes that the same tax and regulatory policies should govern foreign controlled firms which regulate domestic firms except where cultural and
national security interests demand otherwise.\textsuperscript{56} The principle of national treatment or non-discrimination against foreign firms had emerged as customary rule of international law and had been accepted by Canada in 1976 by giving formal assent to the Organization for Economic Co-operation and Development's Declaration on International Investment and Multinational Enterprises. The OECD recognized that equal treatment for domestic and foreign controlled firms did not preclude regulatory instruments\textsuperscript{57} which would ensure that foreign controlled firms did not take decisions adverse to national interests. The convention also authorized prior screening of foreign investors and imposing of special conditions with regard to performance undertakings in case of foreign controlled firms taking over an existing business or beginning a new business.

Apart from liberalization of investment laws, the Macdonald Commission also sees free trade with the US as another means of increasing investment and production in Canada.\textsuperscript{57} It is accepted that an important aspect of trade in Canada is the dependence on a single national market, that of the US. Insecurity of access to this market because of non-tariff barriers creates uncertainties which thwart rationalization of production in Canada. Besides, a free access to the American market would also encourage Canadian investment in the US.
Free trade is seen as the main instrument in the Commission's approach to the industrial policy. Insecure access to the US market prevents firms from making the necessary long-term investments in plant, technology and human resources. Also, free trade would provide access to those areas where US tariff and non-tariff barriers like on some steel products and products in the petro-chemical sector. This, in the view of the Commission, would not increase the dependence of Canada on USA but would lead to greater diversity in economic and trade relations.

Free trade would result in enhancement of productivity because of the increase in the economies of scale which would increase competitiveness in the manufacturing sector. This would lead to specialization and rationalization of Canadian production. The restructuring and rationalization in Canadian industry would increase the competitiveness of Canadian firms with US firms which would, in turn, mean a greater ability to survive in a more competitive global trade environment. Ultimately, creating a more competitive domestic industry would give rise to more jobs and thus reduce unemployment. It would enable Canadian firms to concentrate on their most efficient production lines thus lengthening production runs and further
lowering costs. The resulting expansion of trade would increase the variety of products available to Canadian consumers because although Canadian industry might produce fewer types of each product, more types overall would be available to consumers because of increased trade.

The more efficient industry would increase Canada's advantage over third countries both in the US market and in the markets of the third countries. Thus, removal of barriers would result in lower costs, higher wages and incomes and increased output of the economy in general because of increased and more secure access to American markets. Removal of Canadian tariffs would increase domestic competitive forces and compel rationalization of domestic industry. Removal of foreign-trade barriers would facilitate Canadian penetration of foreign markets permitting economies of scale to be more fully exploited.

It could be argued that removal of barriers might induce significant amount of investment to leave Canada because protection has encouraged these firms to invest in Canada rather than to service Canadian markets from abroad. The Commission accepts that if Canada were to reduce its barriers unilaterally, investors would have less incentive to remain but if US also withdrew its
barriers, then firms which were previously discouraged from investing in Canada because of US trade barriers could enter Canada and produce for both the American and the Canadian market.

The second argument against free trade could be that protection provided a stimulus to manufacturing industry. The Commission again accepted that while unilateral move towards free trade could reduce the size of manufacturing industry, but bilateral free trade could produce a different situation. Increased penetration of markets abroad would in itself be a stimulus to increased production which would offset the reduction caused by removal of protection. However, as this would result in the rationalization of Canadian industry, certain disruptions would take place for labour and other factors of production. These disruptions would be more difficult for Canada than for other developed economies because the Canadian economy was spatially more diverse; and because Canada would be entering into a free trade agreement with a country much larger than its own.

Further, it could be argued that such an agreement would reduce Canada's ability to negotiate multilaterally for access to export markets. The Commission agreed that it would be ideal if Canada could expand and secure
Its access to US markets through multilateral rather than bilateral negotiations but that had not been possible because forums like GATT had eighty-nine members and thirty other countries maintained a de facto application of GATT rules. This unwieldy decision-making forums. Moreover, non-tariff barriers which Canada wanted reduced were often hard to disentangle from a variety of domestic policies which GATT member-States followed. Not only that, GATT itself had a limited administrative capacity as an international institution and, therefore, the possibility of a major breakthrough in the near future were not there.

In any case, the major benefit for Canadians of a successful GATT reduction of non-tariff barriers would be increased security of access to the US market since Canada's trade relations were mainly with the US. Therefore, the primary objective for Canada, whether through a multilateral or a bilateral route, was to gain a more secure access to the US market.

Finally, the question arose whether Canadians would, through such an agreement, feel that they had finally abandoned their traditional objective of maintaining a genuinely independent political community, culturally and socially different.
from the US. The Commission felt that few Canadians now have such a concern because over the years, they had developed a far greater confidence than before about their own cultural distinctiveness and in the distinctiveness of their social and political institutions.

The Other Macdonald Report

The Other Macdonald Report, however, felt that such an agreement would lead to foreign economic domination and work to the detriment of domestic industry. The reasons given are, first, that Canadian manufacturing industry enjoyed few comparative advantages over the American industries. Hence, the removal of tariff barriers would simply lead to the replacement over time of Canadian manufacturing production by American. The Canadian labour thus released from the manufacturing sector would be drawn into the resources and the services sectors, or would emigrate, or would just swell the ranks of the unemployed. Secondly, heavy ownership of the US of Canadian industry would result in Canadian production being relocated in the US even when the Canadian production costs were lower. Finally, Canadian industry would not develop in future in ways beneficial to Canada. The resource sector would be strengthened at the expense of the manufacturing sector which might yield higher income but which would nullify
efforts to foster indigenous technology and research and development necessary for Canadian industry. Thus, we see that the debate continues.

*Investment Canada and FIRA*

**Purpose**

The change of tone of *Investment Canada* indicates the change of attitude. The purpose of *Investment Canada* is stated in section 2: "Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada." This is in contrast to section 2(1) of FIRA which stated that the Act was enacted by the Parliament in recognition of the extent to which control of Canadian industry, trade and commerce had become acquired by persons other than Canadians and of the effect of this control on the ability of Canadians to maintain effective control over their economic environment. This had become a matter of national concern. The purpose of this Act was to establish a means by which measures might be taken to ensure that control of Canadians' business enterprises may be acquired by persons other than Canadians who were not already carrying on business in Canada or
whose new businesses in Canada would be unrelated to business already being carried on by them in Canada only if it had been assessed that the acquisition of control by them or the establishment of new businesses by them was likely to be of significant benefit to Canada.  

**Responsibilities of the Minister**

The change of tone is also evident in the responsibilities given to the Minister responsible for the administration of the Act. In addition to his duties of administration and direction of the Agency established by section 6 of the Act, according to section 5, he is also supposed to encourage business investment; assist Canadian businesses to exploit opportunities for investment and technological advancement; and carry out research and analysis relating to domestic and international investment; provide investment information services and other investment services to facilitate economic growth in Canada; and ensure that the notification and review of investments are carried out in accordance with the Act. The Minister under FIRA had not been given the task of encouraging foreign investment while at the same time reviewing it but as Prof. Paterson points out, the two, in any case conflict with each other. It might, according to him, lead to more approvals than were there in the early years of FIRA, but as Samuel R. Baker...
shows, the approval rate as FIRA evolved, was already more than 96%. The essential character of FIRA was regulatory and not prohibitive. The idea was to ensure that the investments of non-eligible persons met the criteria of significant benefit to Canada.

**Significant Benefit**

In order to assess that significant benefit would result, section 2(2) of FIRA laid down five criteria:

(a) level and nature of economic activity in Canada including the effect on employment; on resource processing, on utilization of parts, components and services produced in Canada, and on exports from Canada;

(b) degree and significance of participation by Canadians in the business enterprise;

(c) effect on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

(d) effect on competition within any industry or industries in Canada;

(e) compatibility of the activity with national industrial and economic policies.

If we compare the criteria of "significant benefit" with that of "net benefit" in *Investment Canada* we find that section 20 71 of *Investment Canada* repeats word for word the five criteria laid down in section 2(2) of FIRA.
and adds one more: "the contribution of the investment of Canada's ability to compete in world markets."

Thus, the word "significant" is omitted. It is enough if a "net benefit" results but since the criteria applied are the same, there need not always be a great difference in the interpretation of "significant benefit" and "net benefit."

Who can invest without being subjected to the regulatory mechanism of Investment Canada

Investment Canada does not use the words "non-eligible person." Those who are subject to the regulatory scheme of Investment Canada are non-Canadians. A "non-Canadian" is defined by section 3 as "an individual, a government or an agency thereof or an entity that is not a Canadian". Therefore, we have to find out who is a Canadian. Section 3 defines a "Canadian" as (a) a Canadian citizen; (b) a permanent resident within the meaning of the Immigration Act, 1976, who has been ordinarily resident in Canada for not more than one year after the time at which he first became eligible to apply for Canadian citizenship; (c) Canadian government or its agency -- federal or provincial; (d) an entity that is Canadian controlled as per section 26(1); or (e) a corporation described in section 26(3).

Therefore, a non-Canadian, and hence subject to review process would be (a) a person not a Canadian citizen; (b) a permanent resident within the meaning of the Immigration Act who has been
Act who has been ordinarily resident in Canada for more
than one year after he first became eligible to apply for
Canadian citizenship; (c) a government of another country
or its agency; (d) an entity that is in actual fact controlled
by non-Canadians; (e) corporation incorporated in Canada
not controlled by Canadians.

Who were the non-eligible persons under FIRA? Section
3(1) defined a "non-eligible person" as (a) an individual
who was neither a Canadian citizen nor a permanent resident
within the meaning of the Immigration Act, 1976. It included:

(i) a permanent resident who has been ordinarily
resident in Canada for more than one year after
the time he first became eligible to apply for
Canadian citizenship.

(ii) a) Canadian citizen who is not ordinarily resident in Canada.
   b) government or agency of a government of another
country;
   c) a corporation incorporated which is in fact
controlled by persons described by (a) and
(b) or a group of persons any member of which
is a person described in (a) or (b) or by
another such corporation.

Therefore, if we put alongside the definitions of
a non-eligible person in FIRA and a non-Canadian in Investment
Canada, we find that the only distinction is that under
FIRA even a Canadian citizen was required to be ordinarily
resident in Canada which is not the case under Investment
Canada. Thus, the very same people are subject to the
regulatory mechanism of the two legislations.
Acquisition of Control

Under Section 28(1) of Investment Canada, control is acquired by (a) acquisition of voting shares of a corporation in Canada, (b) acquisition of voting interests of an entity carrying on a Canadian business or which controls directly or indirectly another entity carrying on a Canadian business. Control may be acquired by acquisition of all or substantially all of the assets used in carrying on a Canadian business.

Under section 28(3), control is presumed to have been acquired when the majority of voting interests or the majority of undivided ownership interests in the voting shares are acquired in case of a corporation; if less than a majority but one-third or more of voting shares are required, then unless it can be established that this does not result in control in fact, it is deemed to be an acquisition.

But not all investments which result in acquisition of control by non-Canadians of Canadian business are subject to review. They become subject to review under section 14 where control is acquired by acquisition of voting interests if the value of the gross assets thus acquired is 5 million dollars or more; or if the value of the gross assets of the controller and the value of the gross assets acquired amount to more than 50% of the value of the gross
assets of the controller and the value of the gross assets acquired amount to more than 50% of the value of the gross assets of the entity controlled and the value of the gross assets acquires is 5 million dollars or more; or where the value of the gross assets of the controller and the controlled amount to 50 million dollars or more.

However, notice of acquisition of control still needs to be given under section 11(b)\(^7\) and section 15 provides that an investment which is not otherwise reviewable becomes reviewable if

(a) it falls within a prescribed specific type of business activity that, in the opinion of the Governor in Council, is related to Canada's cultural heritage or national identity; and

(b) Within twenty-one days after the certificate date referred to in paragraph 13(1)(a),

(i) the Governor in Council, where he considers it in the public interest on the recommendation of the Minister, issues an order for the review of the investment, and

(ii) the Agency sends the non-Canadian making the investment a notice for review.

Section 15 must be read with Schedule IV of the Regulations respecting investment in Canada which prescribes the specific types of business activities as:
1. Publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-readable form,

2. Production, distribution, sale or exhibition of films or video products,

3. Production, distribution, sale or exhibition of audio or video music recordings,

4. Publication, distribution or sale of music in print or machine-readable form.

Therefore, exceptional cases can be reviewed only if they are engaged in the above activities and that too only if the Minister considers the review to be in public interest and the Governor in Council so orders within twenty-one days of the date of filing of the completed notice of the investment. Thus, large number of investments have been taken out of the review process.

New Business

Section 11(a) of Investment Canada talks of "a new Canadian business" which is subject to notification requirements but not to review except in circumstances specified in section 15. A "new Canadian business in relation to a non-Canadian means, under section 3"a business that is not already being carried on in Canada by the non-Canadian and that at the time of its establishment, (a) is unrelated to any other business being carried on in Canada by that non-Canadian".
Under Section 3(1) of FIRA a new business meant "as business not previously carried on in Canada by the person or group of person in relation to which the expression is relevant." Under section 8(2)(a), notice was required by a non-eligible person if he proposed to establish a new business and at that time was not carrying on any other business in Canada. Section 8(2)(b) provided for a notice if the proposed business was related to the business already being carried on.

Thus, the requirements under the two legislations are the same with respect to new business, but the important difference is that whereas a new business was subject to review under FIRA, it is not under Investment Canada except in the circumstances mentioned above.

The Review Process

Most severe criticism of FIRA was regarding the problems of implementation in the review process. The main complaints in this regard were that significant criteria were too vague; it was not always clear whether an investment was reviewable or not; and the agency's opinion had no binding force;
delay; the confidentiality surrounding the whole process so that no reasons were given in case of rejection and thus no guidelines evolved; third-party representations; too detailed an information demanded by the FIR Agency. Investment Canada seeks to remedy some of these problems but the procedures remain unchanged in case of many others.

The criteria for "significant benefit" and "net benefit" are the same except that an additional sub-section has been added in Investment Canada spelling out one more factor to be considered: whether the investment would contribute to Canada's ability to compete in world markets. The change from "significant" to "net" may indicate that the assessment may be less rigorous but not necessarily so. If depends on the interpretation given to it from time to time by the reviewing agency and, if anything, makes it even more ambiguous.

Unlike FIRA, section 37(1)\textsuperscript{80} of Investment Canada makes binding written opinions available to investors on application by them on whether their investment is reviewable or not. Investment Canada also tries to minimise delays by providing time limits at every step. According to section 17,\textsuperscript{81} in case of a reviewable investment by a non-Canadian, the investor must make an application to the Agency.
in the manner prescribed and containing the information prescribed in Schedules II and III of the Regulations. The Agency must send the receipt of the application within fifteen days of receiving the application failing which, the application would be deemed to be received by the Agency complete in all respects. The Minister must complete his review within 45 days or within a further period of 30 days after which, if no notice has been sent by the Agency, the application is deemed to have been accepted. In case, the Minister thinks that the investment is not likely to result in net benefit to Canada, the applicant will be given another thirty days to make further representations.

It will be noticed that decision-making on the application has been shifted totally to the Minister. Under FIRA, the decision was made by the Minister and the Cabinet. As the Macdonald Report points out this "creates a substantial risk of arbitrary action." The Report accepts that the Cabinet is too busy to examine all proposed takeovers and, therefore, recommends "a quasi-judicial tribunal to review foreign investment." The confidentiality surrounding the process has been retained and can only heighten the feeling of arbitrariness. The Report emphasizes
the "need for public proceedings and full public disclosure" and feels that "non-government intervenors should have a chance to argue the issues in public. Moreover, the tribunal should publish a report that sets out the economic, or other, policy reasons for its actions." ^4

Conclusions

Investment Canada reveals a more positive approach to foreign investment than FIRA. A much larger number of investments have been left out of the review process and the procedure for review has been streamlined. All this may encourage a greater amount of foreign investment, but the concerns for ownership and control, and more particularly control, remain the same. The idea is to encourage greater investment while, at the same time, retaining fairly strict control over foreign direct investment.

In some cases the investor may find himself unable or unwilling to meet the criteria required for net benefit to Canada and the government may require some additional elements of benefit if the investment is to be allowed. In spite of GATT ruling, section 19(c) does provide for "any written undertakings to Her Majesty in right of Canada given by the applicant." ^5
Canada given by the application. In an extreme case, the government may feel that Canadian control is absolutely essential if, for example, the investment is in a field of special public interest such as the cultural industries. The government may also discourage subsidiaries of foreign corporations whose only aim is to distribute foreign manufactured goods in Canada. Thus, the aim of Investment Canada as it was of FIRA is essentially to direct the attention of foreign investors to Canadian economic policies. The degree of control required for this purpose may vary according to perceived needs and changes in economy and according to policies of different governments, but the essential aim remains unchanged.

It has to be also realised that Canada is not an exception in putting restrictions. The Americans, themselves, have many barriers to foreign investment. Nicholas J. Patterson in "Canada-US Foreign Investment Regulation: Transparency versus diffusion" has pointed out the number of restrictions the Americans have. When Arabs started doing large portfolio investments in USA, concern was expressed by the Congress and it was suggested that controls should be put on those investments. This resulted in a report issued by US Commerce Department in 1976 which ran into 9 volumes and 3,000 pages and which showed the number
of restrictions that already existed on foreigners doing business and investing in USA. Non-resident aliens are prohibited from investing in shipping, radio, television, telegraph, fishing, air transportation, hydro-electric power, atomic energy and mining. On the other hand, US companies control over 15% of Canada's entire national telephone system. Halco Inc. owned by a US citizen has large trade between Canadian ports. But Upper Lakes Shipping which has a Canadian owner does not have a similar trade between US ports. Restrictions are widespread. The only difference is that they have not been put together under one legislation and there is no single agency to regulate the foreign investment.

Other countries, too, have substantial restrictions on direct foreign investment. Japan is the most restrictive. France is probably the most restrictive in Europe. In many cases, the British Government obtains "Statements of future intentions" from foreign investors and they are required to provide for performance requirements governing local procurement, employment and exports.

FIRA represented an aspect of Canada's search for national identity which feels threatened when the economy is dominated by foreign investment from one single country.
This identity is sought to be preserved in Investment Canada through the net benefit criteria and through provisions of Schedule IV of the Regulations respecting investment in Canada. Canadians do not see any dangers in foreign investment. This is evident from the way the economy has developed through large inflows of foreign direct investment. When Canadians talk of control, it seems largely with reference to American investment because of its dominant character and the feeling of insecurity it thereby endangers.
Chapter V
TOWARDS AN INTERNATIONAL CODE OF CONDUCT

Introduction
Need for a universally accepted code

Unregulated foreign investment as we have seen, can impose costs which can detract from the very purpose of allowing the foreign investment. Excessive mining, for instance, can lead to too rapid a depletion of natural resources. Technology may be supplied at an excessively high cost with restrictions on its dissemination which may hamper local initiative, make the country dependent on another, and hinder the development of skilled manpower, technicians and research facilities while at the same time, leading to "brain-drain." It can also result in a branch plant economy and to the production of goods inappropriate for that country. In the case of countries with limited foreign exchange resources, it can place strain on the balance of payments. Thus, while there is an undeniable need for investment, there is also a need to regulate it in order to maximize its benefits and minimize its costs.

Individual countries have tried to regulate foreign investment according to their perceived needs, but as has been pointed out in the Reconvened Special Session of the Commission on Transnational Corporations (17-21 June, 1985),...
it has become clear that national legislation of any one country cannot cope with the international issues raised by the activities of the transnationals.\(^1\) The situation has been further aggravated because of corporate misconduct in the 1970s such as interference in the internal affairs of States, illicit payments and unethical marketing practices. Further, regulation solely through national legislatures leads of multinationals being subjected to several and often contradictory sets of laws. Besides, there have been problems because of nationalization and expropriation of property and disputes pertaining to settlement of claims regarding compensation.

Efforts have also been made by various agencies of the United Nations and by international business and labour organizations to formulate international or regional instruments dealing with standards and principles of Transnational corporations. Some of the instruments that have resulted are The OECD Guide-lines for Multinational Enterprises, The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, the Draft International Code of Conduct on the Transfer of Technology and The International Code of Marketing of Breast-Milk Substitutes.
Nations have also tried to regulate foreign investment through bilateral treaties.

Each of these endeavours is necessarily limited in scope. Bilateral treaties, for example, are basically investment protection treaties which try to establish the treatment that the host country will give to the multinationals, but do not at the same time, regulate the behaviour of multinationals, hence they are not balanced. Moreover, while individual countries may agree to clauses like "Prompt, adequate and effective" compensation for nationalization, they have been subject of much controversy in various international forums. For these reasons, a number of countries have reservations on bilateral treaties as regulatory instruments providing a definitive settlement of controversial issues. As Raymond Vernon has pointed out: "The fundamental difficulty with these treaties is that they provide unrealistic guarantees for the foreign direct investor, guarantees which cannot be sustained in the long run..... Any developing country that agrees to such terms could only be doing so as a gesture, one that could scarcely be expected to survive for long in the normal internal political processes of most countries." 2
As far as instruments which have already been adopted at the multilateral level are concerned, they are specialized in their scope and subject matter. Only the OECD Guidelines deal with almost all the aspects of the operations of the multinationals, but then these guidelines are only to be observed by multinationals operating in OECD countries. The other instruments mentioned before are to be implemented in all countries but are specialized in scope. The negotiation on a code of conduct for transnationals in the Commission on Transnational Corporations are the only attempt to formulate a comprehensive multilateral code of conduct.

The experience of General Agreement on Trade and Tariffs and International Monetary fund shows that "the establishment of multilateral policy and institutional framework provides the stability and predictability that facilitates international economic co-operation." Also, the General Assembly Resolution pertaining to the International Development Strategy for the Third United Nations Development Decade shows a continued concern for the possible negative effects of transnational corporations. It also expresses the hope that the Code on Transnational Corporations would be adopted expeditiously in order to eliminate the negative effects of transnational corporations and to promote their positive contributions to the development efforts of developing countries consistent with their national development plans and priorities.
Steps towards formulation of the code

Since there was general agreement that a code of conduct should be formulated, the Group of Eminent Persons recommended that the Economic and Social Council should be the main organ of the United Nations responsible for this, and that it should discuss issues related to the operations of multinationals once a year. The Group also proposed that a Commission on Transnational Corporations should be established to aid and advise the Economic and Social Council on issues and problems brought to it annually relating to transnational corporations. The proposal was endorsed by the Secretary General in the fall of 1974 and a Commission on Transnational Corporations was set up with 48 members. The term of office is three years on a staggered basis and elections are held annually which are conducted by the Economic and Social Council.

The Group also recommended the establishment of a research and information centre to provide administrative and substantive services to the Commission on Transnational corporations (CTN). Accordingly, an Information and Research Centre (RC) was set up to function under the guidance of the Commission on Transnational Corporations and administratively under the Centre on Transnational Corporations (CTC).
The Commission on Transnational Corporations has been meeting annually since 1975. The complete divergence of views between developing and developed countries evident in the Report of the Group of Eminent Persons read with the attached comments was also to be seen in the first meeting of the Commission on Transnational Corporations and, often, there was an air of confrontation. The Group of 77 representing the Third World countries and a group of Western delegations consisting of France, West Germany, Italy, UK and USA submitted lengthy lists of their respective areas of concern.\textsuperscript{6} While the Group of 77 focussed on the many activities and operations of the transnationals and expressed their fears about them, the group of Western delegations was mainly concerned with the relations between the multinationals and the governments of the host countries with respect to issues related to discriminatory treatment of multinational subsidiaries, expropriations, and the type of investment climate prevailing in developing countries.

Repeated discussions gradually led to the narrowing down of the divergence of views till in 1983 a draft code emerged in which agreement had been reached on about two-thirds of its provisions.\textsuperscript{7} It was decided early in the deliberations on the code that the code would consist of six chapters: preamble and objectives; definitions; major principles and/or issues related to the activities of transnational corporations; major principles and/or issues
Relating to the Treatment of Transnational Corporations; Legal Nature and Scope of the Code; and Implementation. It was found that the gap between the opposing positions was too wide to deal immediately with chapters two, five and six, i.e. definitions, legal nature and scope of the code; and implementation. There were more points of agreement with regard to issues under preamble and objectives; treatment of transnational corporations; and activities of transnational corporations and, therefore, attempts were made to draft the paragraphs dealing with these areas first.

Areas of International Agreement

Agreement has been reached in some cases ad referendum, on the major part of the chapter dealing with the activities of Transnational Corporations. (Paragraphs 6-46), on paragraphs dealing with Intergovernmental Corporation (Paragraphs 59-65), and the Implementation of the Code of Conduct. In the area of conflict of jurisdiction, too, agreement has been reached.

Co-operation with Host States

There is broad agreement that transnational corporations should have respect for the national sovereignty of the host State and that each State has a right to exercise its sovereignty within its territory. Transnational corporations are subject to the laws of the host country which has the right to regulate and monitor their activities. They must carry out their activities in conformity with the development
policies, objectives and priorities set out by the host country and they must seriously work in a way that they make a positive contribution to the development in the host countries.¹⁰

Contracts must be entered into in good faith and must normally contain renegotiation clauses. In the absence of these clauses too, transnational corporations should cooperate in good faith with the government of the host country to renegotiate where a fundamental change of circumstances has taken place.¹¹

Paragraphs dealing with transnationals having respect for social, and cultural objectives, values and traditions of the host country; respect for human rights and fundamental freedoms in the host country; and non-interference in the internal political affairs of the host country have also been agreed upon.¹² Paragraph fourteen dealing with non-collaboration with racist minority regimes in Southern Africa has been agreed ad referendum in the working group but not yet by the Commission.¹³

**Intergovernmental Co-operation**

Transnationals should not interfere in intergovernmental relations and should not request their governments to intervene on their behalf till local remedies have been exhausted.¹⁴ These provisions have to be read with paragraphs dealing with intergovernmental co-operation which have been agreed upon.¹⁵ States agree that the objectives
of the Code can only be achieved through intergovernmental co-operation which should be strengthened both at the international level and at bilateral, regional and inter-regional levels. States agree that it is necessary to exchange information on measures taken with effect to the Code and their experience with the Code; to consult on a bilateral or multi-lateral basis as required on matters relating to the Code and its application, and in the development of international agreements and arrangements on issues related to the Code; that States should not use transnational corporations to interfere in the internal or external affairs, and finally, that States should not intervene on behalf of transnationals till the local remedies have been exhausted. In any case, the home government should not use any coercive measures not consistent with the Charter of the United Nations and with the Declarations on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations.

Ownership and Control

With reference to ownership and control, it has been agreed that transnational corporations should make an effort to allocate their decision-making power in a way that they can contribute to the economic and social development of the host countries.
They should also co-operate with the host governments to meet the national objectives of local equity participation and of effective control by the local partner as determined by equity, contractual terms in non-equity arrangements or the laws of the host countries. They should attempt to promote employment and participation in management and direction of the enterprise of adequately qualified nationals of the host country so that their effective participation is enhanced at all levels of decision-making. Not only that, they should contribute to managerial and technical training of local nationals.

Export Objectives

There is basic agreement, too, that transnationals should contribute to promotion and diversification of exports and that they should use available indigenous goods, services and other resources. As has been mentioned before, transnationals should also be responsive to requests by host governments to phase over a limited period of time, the repatriation of capital in case of disinvestment or accumulated profits. They should not engage in short-term financial operations, or manipulate intra-corporate payments or indulge in restrictive trade practices which would have an adverse effect, on the balance-of-payments position of the host country. In effect, they should not do anything which would have an adverse impact on the working of local markets or cause
serious balance-of-payment difficulties. Transfer pricing to avoid taxation or evade exchange control measures should not also be done by transnationals.\textsuperscript{23}

Consumer Protection

Agreement has been reached on matters dealing with consumer protection and environment protection where transnationals are expected to perform their activities in accordance with relevant international standards so that they do not cause injury to the health or safety of the consumers or harm the environment.\textsuperscript{24} They should supply to the competent authorities, if requested to do so, relevant information with regard to health and safety protection, including experimental uses and other related aspects; and prohibitions, restrictions and warnings used on those products or services in other countries.\textsuperscript{25} Appropriate information about the contents and possible hazardous effects of a product must be given to the consumer through labels, accurate and informative advertising. Packaging should be safe.\textsuperscript{26} Transnationals should also co-operate with other international organization to develop and promote national and international standards for protection of the health and safety of consumers while, at the same time, meeting their basic needs.\textsuperscript{27}
Similar provisions have been agreed upon with respect to environment protection.28

**Disclosure of Information**

Paragraphs dealing with detailed disclosure of information including financial as well as non-financial items have been agreed upon. This information is to be made available annually within six months and not later than twelve months from the end of the financial year of the corporation. In addition, semi-annual summary of financial information should where appropriate be also provided.29 The details of information to be given are spelt out in paragraph 44. The forty-sixth paragraph also provides for making available appropriate information to trade unions or other representatives of employees in their organizations in the host countries to enable them to assess the performance of the local entity and, where appropriate, of the entity as a whole. All information given pursuant to these paragraphs is subject to appropriate safeguards so that no damage is caused to the parties concerned.30

**Conflict of Jurisdiction**

There has been considerable controversy on paragraphs 55-58 dealing with conflicts of jurisdiction in case of disputes. It was proposed that a transnational should be subject to the jurisdiction of the host country; that in case of a dispute between a State and a transnational it should be settled by competent courts or other authorities,
or by other agreed means of dispute settlement such as arbitration; that parties should be free to choose the applicable law and the form of dispute settlement; and that in case of conflict of jurisdiction where more than one State had jurisdiction over the transnational or its entities, States should adopt mutually acceptable principles and procedures for the settlement of dispute.

In an effort to find a consensus on the matter it was suggested that issues dealing with transnationals being subject to the laws and courts of the host country should be dealt with elsewhere in the code. What was agreed upon was that in case of conflict of jurisdiction, States should try to avoid such conflicts by not exercising jurisdiction where it more properly belonged to another. They should also endeavour to adopt bilaterally and multilaterally mutually acceptable principles and procedures for the settlement of such conflicts based on the principle of sovereign equality and on respect for mutual interest. This was agreed to in 1984 at the reconvened special session.

**Implementation of the Code**

In order to ensure and promote the implementation of the Code, the States should publicize and disseminate the Code; follow the implementation of the Code in their territories; and report to the United Nations Commission on Transnational Corporation the action taken at the national
level to implement the Code, and the experiences gained from its implementation; and do everything else necessary to support the Code.\textsuperscript{32} It has been agreed that the Commission on Transnational Corporations shall perform the functions of the international institutional machinery responsible for the implementation of the Code and the Centre on Transnational Corporations will act as the Secretariat to the Commission.

The Commission shall be the focal point of all activities concerned with matters in the Code and shall have the following functions.\textsuperscript{33} First, it shall hold discussions on matters relating to the Code and facilitate intergovernmental consultations on specific issues related to the Code. Second, it shall periodically assess the implementation of the Code on the basis of the reports submitted by the Governments and on documents submitted by United Nations organizations and specialized agencies. The first assessment is to take place not earlier than two years and not later than three years from the date of adoption of the Code. The second assessment is to take place two years after the first assessment and then the periodicity is to be determined by the Commission on Transnational Corporations. In case any government wants a clarification on any provision in trying to apply it to a particular situation, the Commission shall provide the
clarification but without drawing conclusions on the conduct of the parties involved. The Commission has to also annually report to the General Assembly on activities regarding implementation of the Code and facilitate intergovernmental agreements and arrangements on matters relating to specific issues related to the Code. It is also responsible for collection and dissemination of information relating to the implementation of the Code.

A review of the Code has been agreed upon, six years after its adoption, but the modalities of the review have not been worked out. Further discussion on this subject has been deferred till issues like the mode of adoption and the legal nature of the Code have been settled.

**Outstanding Issues**

**Preambles and Objectives**

With regard to both the preamble and objectives, two basic option have emerged during the discussions. One is to have a short formal preamble recalling the legislative history of the Code and the work of the other bodies of the United Nations in this sphere. The second is that the preamble could in addition contain more substantive matter reflecting the substantive provisions of the Code and the positive and negative aspects of the operations of transnationals.
Similarly, the objective could reflect the position of the United Nations as stated in its International Development Strategy; the desire of the States to establish a mechanism which would lead to greater co-operation among them with respect to the activities and treatment of transnational corporations; and the desire to work out international standards and arrangements with regard to transnational corporations in co-operation with the bodies of the United Nations. The second option is that in addition to the foregoing, the statement of objectives could also contain more substantive provisions reflecting the substantive portions of the Code. The objectives could also be reflected by recalling the Declaration and Programme of Action on a New International Economic Order; the terms of reference for the work of the work of the commission on Transnational Corporations, and various resolutions in this context adopted from time to time.  

 Definition and Scope

Although the question of definition and scope of transnational corporations has been under discussion since the work began on the Code, no settlement has yet been reached. The OECD Guidelines and the International Labour Organization in its Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy did not attempt
a precise legal definition. They both included enterprises whose ownership was "private, state or mixed" and who owned or controlled "production, distribution, services or other facilities outside the country in which they (were) based. The degree of autonomy of entities within multinational enterprises in relation to each other varies widely from one such enterprise to another, depending on the nature of the links between such entities and their field of activity and having regard to the great diversity in the form of ownership, in the size, in the nature and location of the operations of the enterprises concerned. 37

Thus, both the OECD Guidelines and the Tripartite Declaration include enterprises which are State-owned, private-owned or with mixed ownership. There is controversy on this issue in the Code. Three possible solutions to the problem have been considered. One is that a footnote to the provision dealing with the scope of the application of the Code could state that the Code applied to all enterprises or entities of all countries irrespective of their origin and type of ownership. The second is that the Chairperson of the Commission on Transnational Corporations should state in the report that all the groups had confirmed that the Code would apply to enterprises which had the characteristics described.
in paragraph 1 of the Code, and to all other enterprises which operated in their countries. Third, that the provision dealing with the scope of the application of the Code should explicitly state that the code applied to all enterprises whether privately owned, or state-owned or of mixed ownership. 38

Free and unrestricted transfer of all payments relating to investments

Some delegations are of the view that the Code should contain a paragraph stating that transnationals should be permitted to freely transfer all payments relating to their investments like income from invested capital and the repatriation of this capital in the event of this investment being terminated, fees for licensing and technical assistance, royalties and all other such payments. This should be without prejudice to paragraph 29 of the draft code which recognizes that transnationals should be responsive to the request of host countries with regard to phasing of the repatriation of capital and profits and other payments over a limited period of time where otherwise there would be balance-of-payment difficulties. 39

Many delegations object to the inclusion of such a provision. They feel that if it has to be included it should explicitly state that the transfer would be governed by foreign exchange laws and regulations of the host country. 40
Non-collaboration by transnational corporations with racist minority regimes in Southern Africa

From the beginning of the negotiations on the Code some delegates have advocated that the Code should contain provisions relating to the activities of the transnationals and their collaboration with the racist minority regime in South Africa. Others have condemned apartheid but have raised questions about whether it is proper to have such provisions in the Code.

In order to facilitate the work of the Commission on Transnational Corporations and to give it guidelines on this subject, the Economic and Social Council adopted a resolution in 1980 stating that the Code should:

Deal in the most effective and appropriate manner with the issue of the activities of transnational corporations in South Africa and Namibia, recognizing that concern was widely expressed in the Commission on Transnational Corporations, in the context of the struggle against apartheid, at the collaboration of transnational corporations with the racist minority regime.

In addition, since its Third Session, the Commission has consistently adopted resolutions pertaining to Southern Africa at its annual sessions, but equally consistently some major industrialized countries have either voted negatively on these resolutions or have refrained from voting.
It has also been proposed that the issue of Southern Africa should also be reflected in the preamble and in the Statement of Objectives. In 1983, a text was agreed upon ad referendum but there is controversy on whether the heading, "Non-collaboration by transnational corporations with racist minority regimes in Southern Africa" is an integral part of the provision or not. A major difficulty also seems to be with the term "collaboration" and its implications. The term is not necessarily used pejoratively. It can simply mean co-operation or support of any activity that contributes to the maintaining of the system of apartheid and occupation of Namibia.

Traditionally, international law prohibited expropriation of foreign property without compensation by the expropriating State. It has been conceded that a sovereign State has the right to expropriate foreign property where the expropriation is for a public purpose is non-discriminatory and has been effected with the due process of law. The developed nations have always demanded compensation which is prompt, adequate and effective. Adequate compensation means the fair market value of the going concern together with its future earning prospects, goodwill and other such intangible factors. Post-war experience shows that compensation has often fallen far below the value claimed, that payments have been deferred
and made in non-convertible currency. Considerable differences of opinion have been there on whether international law as it is today requires a State to pay adequate compensation to aliens whose property is taken for public purposes which are deemed to be important for national welfare and where the expropriating State has not discriminated between its own nationals and aliens. Further, although clauses pertaining to prompt, adequate and effective compensation have been inserted in bilateral investment treaties, these standards have not always been actually adhered to in practice.

A number of Latin American countries have questioned the traditional international law of State responsibility, that is the right of a foreign State to protect the life and property of its nationals in the event of the host country's failure to do so as extended by the developed countries to apply to business entities. According to the traditional doctrine, it was not enough for the aliens to be given the same treatment as the nationals. An international minimum standard had to be met so that no matter what treatment was given to the nationals, aliens had to be treated according to that international minimum standard.
The Calvo doctrine dispute this traditional concept by asserting that there could be no interference, diplomatic or by force, by another State in the affairs of a sovereign State.\(^47\) Further, aliens were not entitled to any rights and privileges not available to nationals.\(^47\) Therefore, based on this doctrine, national courts had exclusive jurisdiction in disputes involving aliens and aliens could only seek redress in national courts. The Foreign Investment Code under the Andean Pact reaffirms this position. Under Article 50, member-States cannot accord to foreign investors more favourable treatment than given to their national investors and Article 51 prohibits international adjudication of investment disputes.\(^48\)

The socialist countries of Eastern Europe, too, have rejected the traditional idea of minimum international standard and maintain that the regulation of alien property falls exclusively within the province of national law.\(^49\) The new nations which have emerged from colonialism, again question the universal validity and acceptance of the principles of international minimum standard because they feel that these principles were developed without their participation or consent and that their application leads to results which are unjust and inequitable and which perpetuate the exploitative colonial system beneficial to the developed countries.
They insist that nationalization is a legitimate exercise of national sovereignty subject to no qualifications or limitations.

Acts of nationalization have been inspired by and have, in turn, inspired General Assembly resolutions proclaiming "the right of peoples freely to use and exploit their natural wealth and resources inherent in their sovereignty" and resolutions like "Permanent sovereignty over natural resources." Under this resolution it was accepted that "appropriate compensation" should be paid on nationalization "in accordance with national and international law", subject to the agreement of States and all parties concerned. In case of disputes, they should be settled by arbitration or international adjudication after local remedies have been exhausted. The developing countries accept this because the idea of prompt, adequate and effective compensation has been replaced by "appropriate" compensation; and it is acceptable to developed countries because it recognizes that compensation is to be paid in accordance with national as well as international law.

Thus, the position of the developing countries is as follows: First, they have a right to nationalize foreign property as an attribute of sovereignty and that the property has been nationalized in national interest cannot be challenged by anyone. Second, the amount of compensation should
not exceed the net book value of the investment and should be commensurate with the capacity of the host government to pay. Third, the host country has the right to regulate the entry of foreign investment and the conditions under which the investment must operate. Fourth, the host government can give incentives for foreign investment and can also impose restrictions on its operations in keeping with its development policies. Finally, the host government has the right to negotiate the contract in the light of changed circumstances or to take unilateral action, the effect of which is to modify the contractual or property right of the foreign investor.

Since the positions of developed and developing countries are still at variance with regard to issues of nationalization, compensation, and dispute settlement, no agreement has been reached in the code on clauses dealing with these issues. However, there is agreement that it is necessary to evolve an international public policy framework balancing the rights and obligations of the parties involved.

National Treatment:

It has been recognized in a number of multilateral instruments that developing countries, because of their weaker economic positions need to receive preferential treatment
to help them in their economic development. The idea is also inherent in resolutions calling for the restructuring of international economic relations between developed and developing countries for the establishment of a new international economic order. In the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, it has been specifically stated:

... developed countries, should take into account in their restrictive business practices and development, financial and trade needs of developing countries, in particular of the least developed countries, for the purpose especially of developing countries in:

(a) Promoting the establishment or development of domestic industries and the economic development of other sectors of the economy, and

(b) Encouraging their economic development through regional or global arrangements among developing countries.

Therefore, it is accepted that developing countries can give incentives for the establishment and development of domestic industry and hence can give preferential treatment to domestic enterprise over foreign enterprise as long as this does not amount to a denial of justice. Even in the OECD Guidelines, the principles of national treatment has been seen as a goal to be strived for rather than as an
absolute obligation. 56 Besides, certain exceptions to the national treatment principle have been generally accepted for instance, consideration of public order and national security.

In the draft code, agreement on the national treatment clause has yet to be worked out. A compromise formulation provides for certain specific exceptions to the national treatment principle. Apart from public order and national security, other exceptions suggested are that transnational corporations should not claim incentives and concessions given to domestic enterprise to promote self-reliant development or protect essential economic interests. Some States find this formulation too sweeping. Another clause in the formulation states that national treatment would be accorded when the enterprises operate in circumstances which are similar or identical. But many States feel that such a formulation amounts to negating the very principle of national treatment. Solution could be found if a clear statement is made on fair and equitable treatment of foreign enterprise because that may alleviate the concern about discriminatory treatment. 57

Dispute Settlement

Transnationals may enter into contracts with the government of the host country, with domestic enterprises
or with other transnationals. There is a difference of opinion on the dispute settlement process in such contracts. On view is that disputes arising out of such contracts are subject to the laws of the host country. Another view makes a distinction between contracts with the Government or its agencies and those with private parties. According to this view, when the contract is with a private party, the parties should be free to choose the law which would govern their contract and the forum for the settlement of any disputes arising out of them.  

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It is felt by some States that if the parties are left free to choose their own law and forum for the settlement of disputes it would undermine the host country's right to regulate and monitor the activities of transnationals operating in its territory; and also oust the jurisdiction of its courts in a large number of cases.  

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Among the OECD countries, a dispute settlement machinery seems to be evolving informally. In case a transnational violates the Guidelines for Multinational Enterprises, a complaint can be lodged with a contact point usually in the external affairs department. The complaint is then communicated to the home government of the transnational. It is a method of bringing moral pressure to bear on the transnational. Similarly, if the UN Code was universally accepted, some such mechanism may evolve for dispute settlement.

Non-interference in internal affairs

It is well-established principle of international law that States should not interfere in the affairs of other States
and, therefore, there is no controversy about the inclusion of such a provision in the Code. The divergence of views is on the scope of the provision. On the one hand, interference means nothing more than the perceived inability of State to formulate its economic policies because it feels that it is in a weak bargaining position compared to some transnationals which are very powerful because of their size, resources and economic power. On the other, it may refer to surreptitious activities.

In view of this, some delegations feel that the Code should specify that transnationals should not indulge in activities that undermine the political and social systems of the host country and that reference should be made to illegal interference and illicit activities as the term "internal affairs" was too wide in itself. Others feel that subversive activities formed a category in themselves and that the concept of non-interference was wider than that. No agreement has yet been reached. An effort has been made to combine the two points of view and a compromise formulation has been suggested but no consensus has as yet emerged.

Basis for Concluding Document: Proposal by the Chairmen of Working Groups I and II

In order to complete the formulation of the code of conduct, the Economic and Social Council decided to hold a special session of the Commission on Transnational Corporations
by its resolution 1982/68 of 27th October, 1982. The Commission decided to establish two working groups. Working Group I, chaired by the Rapporteur, was to consider sections of the draft code dealing with definition and scope of application, and the preamble and the objectives. The second Working Group was to be chaired by the Chairman of the Special Session and it was to consider outstanding issues relating to the treatment of transnational corporations and their activities.

The Chairman of the two working groups presented a working paper on the basis of extensive discussion of the elements contained in it as a possible settlement of the outstanding issues. Many delegations have repeatedly expressed the view that they are willing to accept the proposals in the working paper as a compromise solution provided other delegations are willing to accept them too. The two Chairmen also felt that these proposals represented a delicate balance between the positions of various groups and any major change was likely to upset the balance.

Paragraphs 1 to 3 of the Working Paper dealt with the definition of a transnational and scope of application of the Code. A transnational corporation was defined as
an "enterprise, comprising entities in two or more countries regardless of the legal form and field of activity of these entities, which operates under a system of decision-making, permitting coherent policies and a common strategy through one or more decision-making centres, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the activities of others and, in particular to share knowledge, resources and responsibilities with others." 63 It was explicitly stated that the Code applies to any enterprise having these characteristics regardless of its ownership and that it is universally applicable and open to adoption by all States. 64

As mentioned before, there was broad agreement on the question of States having sovereignty over their natural resources and wealth but there were some reservations on the right of the States to exercise this sovereignty; whether the right should be exercised in accordance with international law or in accordance with agreements reached by the countries concerned on a bilateral and multilateral basis. In the proposal, it has been clearly stated that transnationals must respect the national sovereignty of the host countries and that each State had the right to exercise its permanent sovereignty over its natural resources and wealth. 65
Again, some States had sought to modify the formulation that transnationals were subject to the jurisdiction of the host country with the qualification, "to the extent required by the national law of these countries." The Proposal removes any such qualification and clarifies that the transnational is subject to the jurisdiction, laws, regulations and administrative practices of the host country.66

In the national treatment clauses, it is proposed that transnationals should receive fair and equitable treatment in the host countries. The national treatment principle has been qualified by requirements for maintaining public order and protecting national security; vital national interests consistent with socio-economic systems as reflected in national constitutions and other laws; and the declared development objectives of the developing countries. Also, transnationals should be given the same treatment as domestic enterprises "when the circumstances under which they operate are similar."67

With respect to nationalization, the working paper only advocates payment of compensation by the State concerned "in accordance with the applicable legal rules."68 Disputes between States and entities of transnational are to be submitted to competent national courts or authorities; but
if the parties mutually agree, disputes may be referred to other dispute settlement procedures. 69

Conclusion

Therefore, we see that agreement has been reached on many important issues dealt with in the Code and on others, possible solutions exist on which agreement is possible. Also, the need for international regulation of foreign investment has been acknowledged. In the absence of it, States have tried to resolve the problem through national legislation, regional arrangements and bilateral investment treaties. Certain agencies of the United Nations have also tried to work out codes of conduct regarding issues pertaining to transnational corporations but all these efforts have been limited by scope and subject.

In order to make the Code a reality, it has been suggested that paragraphs on which agreement has been reached should be adopted as part of the Code while negotiations should continue on others. This, however, is not practical because the outstanding issues are as vital as nationalization and compensation, the principle of national treatment, dispute settlement, what constitutes internal affairs of a country and the concept of non-interference in them by transnationals.
In the absence of agreement on such issues, the Code is not likely to succeed.

Another major obstacle in the negotiations concerning the Code has been controversy on whether the Code should be a mandatory or a voluntary instrument. The view of United States and other developed industrialized countries is that the Code should be voluntary in character. The developing countries, on the other hand, would like the Code to be mandatory. However, it seems that a decision on the exact nature of the Code is not as important as agreement on the issues by all the parties concerned and their political commitment to make the Code effective through its implementation and follow-up procedures. An instrument may be legally binding and yet may be violated with impunity whereas even a voluntary instrument may be effective if there is political commitment towards it. This is particularly true in the sphere of international law which, by its very nature, cannot have strong enforcement machinery.

Besides, the instrument has a greater chance of acceptance if, to begin with, it is voluntary in nature. It would help to resolve the difficulties in connection with some formulations where there is agreement on the concepts
because then the text would not have to be couched in precise legal terms. For example, all States agree that a sovereign State has the right to nationalize and the corresponding duty to pay compensation. The difficulty lies in elaborating the standards according to which the compensation has to be paid.

Again, a legally binding Code means that not only should the concept being formulated be generally accepted and universally adopted, its language must also be so agreed upon. Consensus has already been obtained both on the concepts and the language for two-thirds of the Code. The adoption of the Code should not be held up because of controversies of language with regard to the rest of the one-third of the Code.

Moreover, it is extremely difficult to obtain consensus for every paragraph in a comprehensive legally binding code where there are so many sovereign States with such widely differing interests and the issues being dealt with are of such great complexity. If the instrument were to initially contain general standards and norms, it would be an important first step in the direction of international regulation of foreign investment and there would be room evolving the more detailed implications of these issues.
Also, it has to be remembered that it is not possible to anticipate every situation that may arise however comprehensive the Code may be. Other international instruments have also been going through a process evolution. Even national legislation involving public policy evolves with time and has to be refined through amendments. The OECD Guidelines have already been formally reviewed twice since their adoption in 1976. Similarly, there are provisions for review in the light of experience gained in the Tripartite Declaration on Multinational Enterprises and Social Policy and in the International Code of Marketing of Breast-Milk Substitutes. Further, in international law, when certain principles become so widely accepted, that they become part of the international psyche, they gain the status of customary international law and by themselves acquire a mandatory character. Hence, if the Code was adopted and given a chance to evolve its norms are more likely to become part of customary international law than if it is not adopted at all.
CONCLUSION

In the preceding chapters we have examined the foreign investment perspectives, policies and laws of a developed and a developing country, viz. Canada and India. They indicate that foreign investment is a useful tool for accelerating the process of growth and development. We have seen that in case of a developing country like India, it can be an important means of augmenting resources and technological capabilities. It can act as a catalyst for the growth of indigenous industry, skilled manpower and entrepreneurship. It encourages the adaptation of technology to local needs, the advancement of research and the development of an industrial culture which is a prerequisite for economic prosperity.

The examination of Canada's experience has shown how foreign investment has played a vital role in the economic development of a developed country. Foreign investment has been an important source of capital and know-how, has led to the efficient exploitation of natural resources and accelerated the establishment of industrial structure in Canada. In both countries the need has been felt to regulate foreign investment in order to maximize its benefits and minimize its costs.
Most of the developing countries, being erstwhile colonies, are underdeveloped because they have missed the industrial revolution. They are latecomers to industrialization by about a hundred and fifty years. They have to bridge the gap but lack resources, technology, skilled manpower, and infrastructure. They need foreign direct investment for their economic development but feel in a weak bargaining position with respect to transnationals. While they are well aware of the benefits of foreign direct investment, they can ill-afford the costs. Hence, they find it necessary to regulate foreign direct investment in order to channelize it for their economic development. At the same time they offer incentives to attract foreign direct investment which place an intolerable burden on their economies. This defeats the very purpose of the investment and leads to two results: transnationals are subjected to multiple and often contradictory laws; these laws sometimes change abruptly and apparently capriciously because the economies cannot sustain the incentives offered.

Transnationals often invest in developing countries in search of new markets, cheaper costs of production, and greater profits. Besides, expanding markets means more jobs. By 1979, one US worker in twenty was employed in production of exports for the third world countries. When, however, the economic and political environment is not stable they
can be subjected to unfair expropriation or nationalization. It, therefore, lies in the interest of both developing countries and the transnationals to accept international regulation of foreign direct investment.

In case of developed countries like Canada and Australia which are "primarily host countries to foreign investment", it has been necessary to "employ screening mechanisms and restrict foreign involvement in some sectors for cultural or economic reasons". In Canada, the majority of foreign direct investment is from USA resulting in a high percentage of ownership and control of non-financial Canadian industry. US is also Canada's largest trading partner. Over 70% of Canada's exports go to US about the same percentage of imports come from US. This makes Canada dependent on US markets. Being dependent both for investment and trade leads to a feeling of insecurity. Regulation of foreign direct investment is essentially concerned with maintaining an independent cultural and economic identity.

As was pointed out by Hon. Gerald Regan, Minister of State (International Trade), all countries impose restrictions on foreign investment insome way or the other. In USA itself, for example, there are restrictions on foreign investments in sectors like shipbuilding, dredging, fishing, air transport, communications, finance, nuclear power, mining and defence
procurement industries. Besides, laws relating to anti-trust and securities can be used to prevent acquisitions by foreigners when these are not in US interest. Restrictions in countries like US and Great Britain, which are home countries for large portions of foreign direct investment, "involve considerations of security and defence as well as economic considerations". France and Japan use various administrative measures to protect their trade and investment interests.

Therefore, restrictive measures in varying degrees and form are being used by all countries, whether developed or developing, although all of them recognize the potential benefits of a liberal trade and investment environment. It all points to a need for universally agreed principles and guidelines with regard to foreign direct investment. The position has been succinctly stated by Hon. Gerald Regan: "There are no absolute rights and wrongs. There must, however, be a balance of interests among states that recognize their national responsibilities and the desirability of a relatively liberal international trade and investment climate. MNEs must commit themselves to contribute to development by following the laws and policies of the countries in which they operate, and international guidelines."

The realization of the need for clear guidelines for transnational corporations led to the establishment of the
Commission and Centre on Transnational Corporations which began the work of elaborating a code of conduct for transnational corporations in 1977. The Organization for Economic Cooperation and Development has also developed guidelines for transnational corporations and for the conduct of host governments towards transnational corporations but these guidelines only apply to the OECD countries. The number of host and home countries has been steadily increasing and the newly-industrialized countries have also a large stake in creating a positive climate for direct investment.

Agreement, as we have seen, has been reached on the major portion of the draft code worked out by the Commission on Transnational Corporations. Given the political will, it is possible and desirable to accept this code. However, we must remember that the centre of regulation would still have to remain national legislation. The adoption of the Code could lead to activity at the national level to make the instrument more effective. It could inspire national regulations and policies to secure a greater application of the principles agreed upon at the international level. In fact a provision could be included in the Code itself to say that States should endeavour to incorporate the principles and norms contained in the Code. Universal acceptance of those principles coupled with efforts at the national level to make them effective would compel the transnationals to respond, too, and be good corporate citizens in accordance with these standards. This would make foreign investment a truly valuable tool for economic development.
NOTES

INTRODUCTION


2. No agreement has been reached on the definition and scope of transnational corporations in the Code of Conduct being worked out by United Nations Commission on Transnational Corporations. The OECD Guidelines and the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy have also not given a precise legal definition.


5. Ibid.

6. Ibid., p.4.

CHAPTER I


3. Ibid.

4. UN Document ST/ECA/190, p.50.

5. UN Document E/C.10/38, p.90.


Also See UN Document ST/ECA/190, p.48.


See Also Gray Report, pp.253-290.

8. Watkins Report, p.49


11. UN Document ST/ECA/190, p.54. See Also footnote 29.


16. UN Document E/5500/Rev.1. Report of the Group of Eminent Persons to Study the Impact of Multinational Corporations on Development and on International Relations. From now on referred to as Report, p.38. The Group consisted of the following:

L.K. Jhaj (Chairman) India.
George Kaham (Vice-Chairman) Tanzania.
J. Irwin Miller (Vice-Chairman) USA.
Pierre Uri (Vice-Chairman) France.
Juan Somavia (Rapporteur) Chile.
Eurik Blum -- Yugoslavia.
Tore Browaldh -- Sweden.
John J. Deutsch -- Canada.
Mohamed Diawara -- Ivory Coast.
John Dunning -- U.K.
Antonio Estrany y Gendre -- Argentina.
Ahmad Ghozali -- Algeria.
J.D. Ivanov -- USSR.
Jacob Javits -- USA.
Ryutaro Komiya -- Japan.
Sicco Mansholt -- Netherlands.
Hans Mattheofer -- FRG.
Mohammad Sadli-- Indonesia.
Hans Schaffner-- Switzerland.
Mario Trindade -- Brazil.

17. Ibid., p.103.

18. Ibid., pp.44-45.

19. Ibid., p.74.

20. Ibid., p.79.

21. Ibid., p.90.

22. Mr. Ryutaro Komiya, representative from Japan, was at that time Professor of Economics, Tokyo University.

23. Mr. Jacob Javits, representative from USA was at that time a Senator.

24. Mr. Irwin Miller, representative from USA, was at that time Chairman, Cummins Engine Co., Inc.

25. Mr. Hans Schaffner, representative from Switzerland, was a former President of the Swiss Confederation and at that time was Vice Chairman of SANDOZ, S.A.
27. Ibid., p.57.
29. Ibid., p.59.
30. Ibid. See Also pp.36 and 37.
31. Ibid., p.105.
32. Ibid., p.144 and p.145.
33. Ibid., p.47.
34. Ibid., p.107, p.119.
35. Ibid., p.66, p.67, p.68.
36. Ibid., p.155, and p.130.
37. Ibid., pp.121-122.
38. Ibid., pp.83, 84, 85. See Also p.40.
39. Ibid., p.87.
40. Ibid., p.93.
41. Ibid., p.150.
42. Ibid., p.67.
43. Ibid., p.111.
44. Ibid., p.140.
45. Ibid., p.116.
46. Ibid., pp.122-123.
47. Ibid., p.129.
48. Ibid., p.151.
49. Ibid., p.119.
50. Ibid., p.117.
51. Ibid., p.113.
52. Ibid.
CHAPTER II


3. Ibid., pp.112-120.


See Also Barbara Ward, "The Decade of Development", pp.25-27. A major theme in the Macdonald Commission Report is that Canada's domestic market is too small to sustain its economy. It is, therefore, very important for Canada to ensure assured access to American markets. Report of the Royal Commission on the Economic Union and Development Process for Canada, Minister of Supply & Services, 1985. From now on referred to as Macdonald Commission Report.


9. Ibid., p.29.


11. Ibid., p.178.


See Also, "Towards a Theory of Economic Growth", pp.24-29, Towards a Theory of Economic Growth.


15. Denis Stairs and Gilbert R. Winham, research co-ordinators, *Canada and the International Political/Economic Environment*, Univ. of Toronto Press, 1985, p.49.


19. Quoted by Williams, p.8.

20. Ibid., pp.9-10.

21. Ibid., p.10.

22. Ibid., p.9.


28. Ibid., p.51.

CHAPTER III


5. Nehru, The Discovery of India, p.188.

6. Ibid.


22. Cited by Kust, Foreign Enterprise in India, pp.63-64.


28. See Kidron, Foreign Investments in India, pp.299-321. See Also Private Foreign Investment in its Relationship to Development, Report by the UNCTAD Secretariat. UNCTAD Document TD/134.


See Also p.24. See Also Transfer of Technology, Report by the UNCTAD Secretariat. UNCTAD Document TD/106.

31. The above figures have been taken from Kidron, p.246.

32. Myths and Realities of Foreign Investment in India, Indian Investment Centre, New Delhi, p.3.


34. Ibid.,


38. Study Team Report, p.5.


41. Section 29 of FERA, 1973 : Restrictions on Establishment of Place of Business in India :

(1) (a) carry on in India, or establish in India a branch, office or other place of business for carrying on any activity of a trading, commercial or industrial nature, other than an activity for the carrying on of which permission of the Reserve Bank has been obtained under Section 28;
42. Section 28 of FERA, 1973:

Restrictions on the Appointment of Certain persons and Companies as Agents or Technical or Management Advisers in India.

(1) Without prejudice to the provisions of Section 47 and notwithstanding anything contained in any other provision of this Act or the Companies Act, 1956 (I of 1956), a person resident outside India whether a citizen of India or not, or a person who is not a citizen of India but is resident in India, or a company (other than a banking company) which is not incorporated under any law in force in India or in which the non-resident interest is more than forty percent, or any branch of such company, shall not, except with the general or special permission of the Reserve Bank,—

(a) act, or accept appointment, as agent in India or any person or company, in the trading or commercial transaction of such person or company; or

(b) act or accept appointment, as technical or management adviser in India of any person or company; or

(c) permit any trade mark, which he or it is entitled to use, to be used by any person or company for any direct or indirect consideration.

(2) Where any such person or company (including its branch) as is referred to in sub-section (1) acts or accepts appointment as such agent, or technical management adviser, or permits the use of any such trade mark, without the permission of the Reserve Bank, such acting, appointment or permission, as the case may be, shall be void.

(3) Where any such person or company (including its branch) as is referred in sub-section (1) acts as, or holds the appointment of, any such agent or technical or management adviser as is referred to in that sub-section at the commencement of this Act, or where a permission for the use of any such trade mark granted by such person or company (including its branch) continues to be valid at such commencement, such person or company (including its branch) shall, within a period of six months from such commencement or such further period as the Reserve Bank may allow in this behalf, make an application to the Reserve Bank in such form containing such particulars as may be specified by the Reserve Bank for permission to continue to act, or to hold the appointment, as such or, as the case may be, to continue to permit the use of any such trade mark.
(4) On receipt of an application under sub-section (3), the Reserve Bank may, after making such inquiry as it deems fit, either allow the application subject to such conditions, if any, as the Reserve Bank may think fit to impose, or reject the application:

Provided that no application shall be rejected under this sub-section unless the parties who may be affected by such rejection have been given a reasonable opportunity for making a representation in the matter.

(5) Where any application has been rejected under sub-section (4), the acting, appointment or permission, as the case may be, shall be void on the expiry of a period of ninety days, or such other later date as may be specified by the Reserve Bank, from the date of receipt by the person or company (including its branch) concerned of the communication conveying such rejection.

(6) Where no application has been made under sub-section (3) by any such person or company (including its branch) as is referred to in sub-section (1), the Reserve Bank may, by order, direct such person or company (including its branch) to desist from such acting or appointment or, as the case may be, from permitting the use of any such trade mark on the expiry of such period as may be specified in the direction:

Provided that no direction shall be made under this sub-section unless the parties who may be affected by such direction have been given a reasonable opportunity for making a representation in the matter.

(7) Where any direction made under sub-section (6) has not been complied with by any person or company (including its branch), then without prejudice any action that may be taken under this Act, the acting, appointment or permission as the case may be, shall be void with effect from the expiry of the period specified in the direction.

Explanation: For the purposes of this section,—

(a) "agent" includes any person or company (including its branch) who or which buys any goods with a view to sell such goods before any processing thereof;

(b) "company" means any body corporate and includes a firm or other association of individuals;
(c) "processing" means any art or process for producing, preparing or making an article by subjecting any material to a manual, mechanical, chemical, electrical or any other like operation but does not include any process incidental or ancillary to the completion of a manufactured product such as dividing, pressing, compressing, packing, re-packing, labelling, re-labelling, branding or the adoption of any such treatment as is necessary to render such product marketable to the consumer.

(d) "technical or management adviser" includes any person or company (including its branch) required to tender any technical or management advice, even though the tendering of such advice is incidental to any other services required to be rendered by such person or company.

43. Section 29 (1) (b) of FERA, 1973:
acquire the whole or any part of any undertaking in India of any person or company carrying on any trade, commerce or industry or purchase the shares in India of any such company.

44. Section 29 (2)(a) and (2)(b) of FERA, 1973:
(a) where any person or company (including its branch) referred to in sub-section (1) carries on any activity referred to in clause (a) of that sub-section at the commencement of this Act or has established a branch, office or other place of business for the carrying on of such activity at such commencement, then such person or company (including its branch) may make an application to the Reserve Bank within a period of six months from such commencement or such further period as the Reserve Bank may allow in this behalf for permission to continue to carry on such activity or to continue the establishment of the branch, office or other place of business for the carrying on of such activity, as the case may be.

(b) Every application made under clause (a) shall be in such form and contain such particulars as may be specified by the Reserve Bank.

45. Section 29 (2)(c) of FERA, 1973:
Where any application has been made under clause (a), the Reserve Bank may, after making such inquiry as it may deem fit, either allow the application subject to such conditions, if any, as the Reserve Bank may think fit to impose or reject the application:

Provided that no application shall be rejected under this clause unless the parties who may be affected
by such rejection have been given a reasonable opportunity for making a representation in the matter.

46. Section 29 (2)(d) of FERA, 1973:

Where an application is rejected by the Reserve Bank under clause (c), the person or company (including its branch) concerned shall discontinue such activity or close down the branch, office or other place of business established for the carrying on of such activity, as the case may be, on the expiry of a period of ninety days or such other later date as may be specified by the Reserve Bank from the date of receipt by such person or company (including its branch) of the communication conveying such rejection.

47. Section 29 (2)(e) of FERA, 1973:

Where no application has been made under clause (a) by any person or company (including its branch), the Reserve Bank may, by order, direct such person or company (including its branch) to discontinue such activity or to close down the branch, office or other place of business established for the carrying on of such activity, as the case may be, on the expiry of such period as may be specified in the direction:

Provided that no direction shall be made under this clause unless the parties, who may be affected by such direction, have been given a reasonable opportunity for making a representation in the matter.

48. Section 29 (3) of FERA, 1973:

Notwithstanding anything contained in sub-section (2), the Reserve Bank may, having regard to—

(i) the fact that any person or company (including its branch), referred to in sub-section (1), is carrying on any activity referred to in clause (a) of that sub-section at the commencement of this Act or has established a branch, office or other place of business for the carrying on of such activity at such commencement, in either case, in pursuance of any permission or licence granted by the Central Government, and

(ii) the nature of the activity which is being, or intended to be carried on by such person or company (including its branch),

by order, exempt—
(a) such person or company (including its branch); or
(b) any class of such persons or companies (including their branches); in relation to such activity as may be specified in the order, from the operation of the provisions of sub-section (2), subject to such conditions as may be specified in the order:

Provided that Reserve Bank shall not make any order under this sub-section in a case where the activity which is being, or intended to be, carried on is solely of a trading nature.

49. Section 29 (4) (a) of FERA, 1973:

Where at the commencement of this Act any person or company (including its branch) referred to in sub-section (1) holds any shares in India of any company referred to in clause (b) of that sub-section, then such person or company (including its branch) shall not be entitled to continue to hold such shares unless before the expiry of a period of six months from such commencement or such further periods as the Reserve Bank may allow in this behalf, such person or company (including its branch) has made an application to the Reserve Bank in such form and containing such particulars as may be specified by the Reserve Bank for permission to continue to hold such shares.

50. Section 29 (4) (b) of FERA, 1973:

Where an application has been made under clause (a), the Reserve Bank may, after making such inquiry as it may deem fit, either allow the application subject to such conditions, if any, as the Reserve Bank may think fit to impose or reject the application;

Provided that no application shall be rejected under this clause unless the parties who may be affected by such rejection have been given a reasonable opportunity for making a representation in the matter.

51. Section 29 (4) (c) of FERA, 1973:

Where an application has been rejected under clause (b), or where no application has been made under clause (a), the Reserve Bank may, if it is of opinion that it is expedient so to do for the purpose of conserving the foreign exchange, direct such person or company (including its branch) to sell or procure the sale of such shares.
Provided that no direction shall be made under this clause unless notice of such direction for a period of not less than ninety days has been given to the person or company (including its branch) to the affected by such direction.

Explanation: For the purposes of this section, "company" means anybody corporate and includes a firm or other association of individuals.

52. Guidelines for administering Section 29 of FERA 1973:

These guidelines will apply to Indian companies having more than 40% foreign holdings and branches of foreign companies operating in India while seeking approval for carrying on any activity of a trading, commercial or industrial nature or for starting fresh activities. These will however not apply to non-residents of Indian origin who have been allowed by the Government to make investment in India on a specific condition that neither the capital nor profit/dividends will be allowed to be repatriated.

Branches of foreign companies (except Airlines and Shipping Companies) seeking approval under the Foreign Exchange Regulation Act will be asked to convert themselves into Indian companies as per policy of Government. This would be without prejudice to any other conditions that may be laid down.

53. CATEGORY PROPOSED ACTION

Industrial Activities

(a) Indian companies having more than 40% foreign shareholdings and branches of foreign companies engaged in the production of items specified in Appendix I of Industrial Licensing Policy, February 1973 or engaged in a predominantly export oriented industry (minimum exports being 60% of total production).

(i) Such Indian companies will be allowed to continue on the basis of the existing approvals subject to the condition that they will increase, within a specified period, Indian participation to not less than 26% of the equity of the company.

(ii) The branches of foreign companies will be required to convert themselves, within a specified period, into Indian companies with Indian participation being not less than 26% of the equity of the company.
(iii) Such companies will be subject to dilution formula as and when they come up for expansion.

(b) Indian companies having more than 40% foreign shareholding who have been granted an industrial licence after February 1970 for manufacturing activities in the production of items specified in Appendix I of the Industrial Licensing Policy, 1973 or engaged in predominantly export oriented industry (minimum exports being 60% of total production.

(c) Indian companies having more than 40% foreign shareholding and branches of foreign companies having a valid industrial licence and engaged in production of items not specified in Appendix I of Industrial Licensing Policy, 1973 but engaged in the manufacturing activities which need sophisticated technology.

(i) They will be exempt from the provisions of Section 29 subject to the condition that they will increase, within a specified period, Indian participation to not less than 26% of the equity of the company.

(ii) The branches of foreign companies will be required to convert themselves within a specified period, into Indian companies with Indian participation of not less than 26% of the equity of the company.

(iii) In determining whether a technology is sophisticated or not, Department of Science and Technology will be consulted and consideration will be given, inter alia, to aspects such as (i) whether the technology is used for the manufacture of products which would otherwise necessitate imports; (ii) whether the discontinuance of the manufacture of products with
(d) Indian companies having more than 40% foreign shareholding and branches of foreign companies engaged in other manufacturing activities.

(i) Such Indian companies will be required to bring down, within a specified period, foreign shareholdings to the level of 40%.

(ii) The branches of foreign companies will be required to convert themselves into Indian companies having foreign shareholding not exceeding 40%, within a specified period.

(iii) Alternatively, they will be required to change, within a specified period, their character from existing manufacturing activities to predominantly manufacturing activities in the areas specified in Appendix I of Industrial Licensing Policy, 1973 or to engage themselves in predominantly export-oriented industries (minimum exports being 60% of total production).

54. See Appendix I.

55. CATEGORY

Trading Activities

(a) Indian companies having more than 40% foreign shareholding and branches of foreign companies engaged predominantly in internal trading and commercial activities.

(1) No fresh foreign equity participation will be permitted.

(ii) Existing Indian companies will be required to bring down their foreign shareholding to 40% within a specified period.

(iii) The branches of foreign companies will be required to convert themselves into Indian companies having foreign holding not exceeding 40% within a specified period.

(iv) In exceptional cases where they had developed expertise, skills or facilities (distribution
network, etc.) which are not readily available indigenously and are contributing significantly to exports, foreign shareholding more than 40% but not exceeding 74% may be allowed depending upon the merits of each case.

(v) Alternatively, they will be required to change within a specified period, their character from predominantly trading activities to predominantly manufacturing activities in the areas specified in Appendix I of Industrial Licensing Policy, 1973 or to engage themselves in predominantly export oriented Industries (minimum exports being 60% of total production).

(vi) If the above alternatives are not acceptable to them, they will be allowed a reasonable time to wind up their business activities in India.

(b) Manufacturing companies i.e., Indian companies with more than 40% foreign shareholding and branches of foreign companies engaged in trading activities in respect of products not manufactured by them.

(i) They will not be denied permission for internal trading in respect of essential or associate products in the overall interest of the consumers as also of development of ancillaries provided the articles so traded are functionally related to the company's main manufacturing activities and constitute relatively a small portion of the overall activity (not exceeding 25% of ex-factory value of the annual production or Rs.5 crores whichever is less). The approval shall also be subject to the condition that the companies shall not be permitted to use, for internal trade, their trade marks or brand names in respect of the products not manufactured by them.
56. CATEGORY

Other Activities

Indian companies having more than 40% foreign shareholding and branches of foreign companies engaged in:

(a) Construction Activities.

(i) Indian companies having more than 40% foreign shareholding will be required to bring down their foreign shareholding to 40% within a specified period.

(ii) In exceptional cases where they have developed such expertise or skills or technology which is not indigenously available, higher foreign shareholding not exceeding 74% of the equity may be allowed.

(iii) Branches of foreign companies will be required to convert themselves into Indian companies with foreign shareholding not exceeding 40% within a specified period.

(b) Plantation Activities.

(i) Tea plantations will, by and large, be treated at par with manufacturing industries specified in Appendix I of Industrial Licensing Policy, 1973 subject to the condition that they will increase within a specified period Indian participation to not less than 26% of the equity of the company.

(ii) Branches of foreign companies will be required to convert themselves within a specified period, into Indian companies with Indian participation being not less than 26% of the equity of the company.
(iii) Branches of foreign companies engaged in other than tea plantation activities will be required to convert themselves into Indian companies with foreign shareholding not exceeding 40% and the Indian companies will be required to bring down their foreign shareholding to 40% within a specified period.

(c) Consultancy Work.

(i) Technical and Engineering Consultants.

(i) Indian companies having more than 40% foreign shareholding will be required to bring down their foreign shareholding to 40% within a specified period.

(ii) Branches of foreign companies will be required to convert themselves into Indian companies with foreign shareholding not exceeding 40% within a specified period.

(iii) In exceptional cases, if they are engaged in such technology or skills which are indigenously not available, higher foreign shareholding not exceeding 74% of the equity may be allowed on merits.

(ii) Non-Technical Consultants.

(i) So far as the management, financial and accountancy firms are concerned and since sufficient indigenous expertise in these spheres is available in the country, the Indian companies with foreign majority shareholding as well as branches of foreign companies will be required to reduce their foreign shareholding to 40% within a specified period.

(d) Manufacturing companies engaged in consultancy work.

(i) They will be allowed to act as consultants in respect of those areas in which they have developed specialisation. Such facilities will however not be available
to companies predominantly engaged in trading and non-manufacturing activities.

57. Explanatory Notes:

(i) While giving fresh approvals to the cases in accordance with the above guidelines, aspects such as the research and development programme initiated by the Indian company and stipulations which restrict the transfer of technology from the foreign collaborator to the Indian company, restrictions on sub-licensing of technology and stipulations for the acquisition of raw materials and components from the foreign collaborator, existing regulations in respect of the patent law, etc., will be borne in mind.

(ii) Where a company is engaged in multi-activity operations, a total view will have to be taken of all the activities in which a company is engaged while considering the question of allowing it to continue to carry on business. The proportion of activity covered by Appendix I of the Industrial Licensing Policy, February 1973 and those falling outside thereof will be a material consideration. In such cases, if activities outside Appendix I constitute only a minor part of the total activities (not exceeding 25% of ex-factory value of the annual production or Rs.5 crores whichever is less) it will be allowed to continue on the basis of existing approvals, provided Indian participation is not less than 26% of the equity of the company.

(iii) While it will be open to companies primarily falling under Clause I (d) "Other manufacturing activities" or Clause II (a) "Trading activities" to change their character and become predominantly manufacturing companies in the areas covered under Appendix I of the Industrial Licensing Policy, February 1973, or other approved categories under Clause I (c), they would have to obtain the requisite Industrial Licence and other Government approvals in the normal way, within the framework laid down by Government from time to time.

(iv) In the case of 100% export-oriented units the foreign equity participation of more than 74% may be allowed on merits of each case.

After having reproduced above Sections 26 to 29 and the guidelines for administering Section 29, we do not consider it necessary to discuss Sections 26, 27 and 28 any further. However, Section 29 being the most
important Section in the strategy for regulating MNCs, we would like to discuss in some greater detail. But this we shall do with reference to certain dispute-situations which actually arose as a result of attempts to enforce Section 29 of FERA, 1973.

58. See Appendix II.


62. Ibid.


65. *Myths and Realities of Foreign Investment in India*, Indian Investment Centre, p.6.

66. Ibid.

67. Ibid.


72. Myths and Realities of Foreign Investment in India, p.1

73. Ibid.


CHAPTER IV


3. Watkins Report, p.6

4. Ibid., p.8. For American Control of Canadian resources and industry, see Wahn Report, pp.33:38-33:44.


7. Ibid., p.293.


13. Ibid., p.7.
15. Ibid.
16. Ibid., p.440.
17. Ibid., p.463.
18. Ibid., p.441.
20. Ibid., p.439.
22. Article III of General Agreement on Tariffs and Trade:

National Treatment on Internal Taxation and Regulation:

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise
apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; Provided that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner
as to allocate any such amount or proportion among external sources of supply.

8. (a) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

9. The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

10. The provisions of this Article shall not prevent any contracting party from establishing or maintaining internal quantitative regulations relating to exposed cinematograph films and meeting the requirements of Article IV.

23. Article XXIII of GATT

Nullification or Impairment

1. If any contracting party should consider than any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(a) the failure of another contracting party to carry out its obligations under this Agreement, or

(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers
to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representa-
tions or proposals made to it.

2. If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (c) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall prompt-
ly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate. The CONTRACTING PARTIES may consult with contracting parties, with the Economic and Social Council of the United Nations and with any appro-
priate inter-governmental organization in cases where they consider such consultation necessary. If the CON-
TRACTING PARTIES consider that the circumstances are serious enough to justify such action, they may authorize a contracting party or parties to suspend the application to any other contracting party or parties of such con-
cessions or other obligations under this Agreement as they determine to be appropriate in the circumstances. If the application to any contracting party of any concession or other obligations is in fact suspended, that contracting party shall then be free, not later than sixty days after such action is taken, to give written notice to the Execu-
tive Secretary to the CONTRACTING PARTIES of its intention to withdraw from this Agreement and such withdrawal shall take effect upon the sixtieth day following the day on which such notice is received by him.

24. Article II of OECD Guidelines:

National Treatment

1. that Member countries should, consistent with their needs to maintain public order, to protect their essen-
tial security interests and to fulfil commitments relating to international peace and security, accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another Member country (hereinafter referred to as "Foreign-Controlled Enterprises") treatment under their laws, regulations and administrative practices, consistent with international law and no less favourable than that accorded in like situations to domestic enterprises (hereinafter referred to as "National Treatment").

2. that Member countries will consider applying "National Treatment" in respect of countries other than Member countries.
3. that Member countries will endeavour to ensure that their territorial subdivisions apply "National Treatment''.

4. that this Declaration does not deal with the right of Member countries to regulate the entry of foreign investment or the other conditions of establishment of foreign enterprises.


30. Ibid., pp.67-71.

31. Ibid., pp.71-79.

32. Ibid., pp.80-81.

33. Ibid., pp.

34. Ibid., pp.81-84.


37. Ibid.
38. Ibid., p.325-326.
39. Ibid., p.326.
40. Ibid.
41. Ibid.
42. Ibid., p.320. See Also Canadian Bar Association Brief, p.57.
43. Canadian Bar Association Brief, p.58.
44. Ibid., p.16.
45. Ibid., p.21.
46. Ibid., p.35. See Also p.25.
47. Ibid., p.30.
52. Ibid.
53. Ibid., p.235.
54. Ibid., p.235-236.
55. Ibid., p.236-237.
56. Ibid., p.263.
58. Ibid., p.324-325.
59. Ibid., p.325.
60. Ibid., p.332.
61. Ibid., p.332-333.
62. Ibid., p.334.
63. Ibid., p.350-357.
64. The Other Macdonald Report, pp.133-134.
65. Section 2 of *Investment Canada Act*:

**Purpose of Act**

Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada.

66. Section 2 (1) of FIRA:

This Act is enacted by the Parliament of Canada in recognition by Parliament that the extent to which control of Canadian industry, trade and commerce has become acquired by persons other than Canadians and the effect thereof on the ability of Canadians to maintain effective control over their economic environment is a matter of national concern, and that it is therefore expedient to establish a means by which measures may be taken under the authority of Parliament to ensure that, in so far as is practicable after the enactment of this Act, control of Canadian business enterprises may be acquired by persons other than Canadians, and new businesses may be established in Canada by persons other than Canadians, who are not already carrying on business in Canada or whose new businesses in Canada would be unrelated to the businesses already being carried on by them in Canada, only if it has been assessed that the acquisition of control of those enterprises or the establishment of those new businesses, as the case may be, by those persons is or is likely to be of significant benefit to Canada, having regard to all of the factors to be taken into account under this Act for that purpose.

67. Section 6 of *Investment Canada*

**Agency established**

There is hereby established an agency, to be known as Investment Canada, to advise and assist the Minister in exercising his powers and performing his duties under this Act.
68. Section 5 of Investment Canada:

Duties and powers of Minister

(1) The Minister shall

(a) encourage business investment by such means and in such manner as the Minister deems appropriate;
(b) assist Canadian businesses to exploit opportunities for investment and technological advancement;
(c) carry out research and analysis relating to domestic and international investment;
(d) provide investment information services and other investment services to facilitate economic growth in Canada;
(e) assist in the development of industrial and economic policies that affect investment in Canada;
(f) ensure that the notification and review of investments are carried out in accordance with this Act; and
(g) perform all other duties required by this Act to be performed by the Minister.

Other powers

(2) In exercising his powers and performing his duties under this Act, the Minister

(a) shall, where appropriate, make use of the services and facilities of other departments, branches or agencies of the Government of Canada;
(b) may, with the approval of the Governor in Council, enter into agreements with the government of any province or any agency thereof for the purposes of this Act; and
(c) may consult with, and organize conferences of, representatives of industry and labour, provincial and local authorities and other interested persons.

69. R.K. Paterson, "Legal Restrictions on Foreign Investment in Canada", Canadian International Trade and Foreign Investment Law. To be Published.

71. Section 20 of Investment Canada:

For the purposes of section 21, the factors to be taken into account, where relevant, are

(a) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;

(b) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;

(c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

(d) the effect of the investment on competition within any industry or industries in Canada;

(e) the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and

(f) the contribution of the investment to Canada's ability to compete in world markets.

72. Section 3 of Investment Canada:

Definitions

In this Act,

"Agency" means Investment Canada established by section 6;

"assets" includes tangible and intangible property of any value;

"business" includes any undertaking or enterprise capable of generating revenue and carried on in anticipation of profit;

"Canada" includes the territorial sea of Canada as determined in accordance with the Territorial Sea and Fishing Zones Act, the seabed and subsoil therebelow and all other areas beyond the territorial sea of Canada where Canada has or claims jurisdiction;
"Canadian" means

(a) a Canadian citizen;

(b) a permanent resident with the meaning of the Immigration Act, 1976 who has been ordinarily resident in Canada for not more than one year after the time at which he first became eligible to apply for Canadian citizenship;

(c) a Canadian government, whether federal, provincial or local, or an agency thereof, or

(d) an entity that is Canadian-controlled, as determined pursuant to section 26;

"Canadian business" means a business carried on in Canada that has

(a) a place of business in Canada,

(b) an individual or individuals in Canada who are employed or self-employed in connection with the business, and

(c) assets in Canada used in carrying on the business;

"corporation" means a body corporate with or without share capital;

"entity" means a corporation, partnership, trust or joint venture;

"joint venture" means an association of two or more persons or entities, where the relationship among those associated persons or entities does not, under the laws in force in Canada, constitute a corporation, a partnership or a trust and where, in the case of an investment to which this Act applies, all the undivided ownership interests in the assets of the Canadian business or in the voting interests of the entity that is the subject of the investment are or will be owned by all the persons or entities that are so associated;

"Minister" means such member of the Queen's Privy Council for Canada as is designated by the Governor in Council as the Minister for the purposes of this Act;

"new Canadian business", in relation to a non-Canadian, means a business that is not already being carried on in Canada by the non-Canadian and that, at the time of its establishment,

(a) is unrelated to any other business being carried on in Canada by that non-Canadian, or
(b) is related to another business being carried on in Canada by that non-Canadian but falls within a prescribed specific type of business activity that, in the opinion of the Governor in Council, is related to Canada's cultural heritage or national identity;

"non-Canadian" means an individual, a government or an agency thereof or an entity that is not a Canadian;

"own" means beneficially own;

"person" means an individual, a government or an agency thereof or a corporation;

"prescribed" means prescribed by the regulations made pursuant to this Act;

"voting group" means two or more persons who are associated with respect to the exercise of rights attached to voting interests in an entity by contract, business arrangement, personal relationship, common control in fact through the ownership of voting interests, or otherwise, in such a manner that they would ordinarily be expected to act together on a continuing basis with respect to the exercise of those rights;

"voting interest", with respect

(a) a corporation with share capital, means a voting share,

(b) a corporation without share capital, means an ownership interest in the assets thereof that entitles the owner to rights similar to those enjoyed by the owner of a voting share, and

(c) a partnership, trust or joint venture, means an ownership interest in the assets thereof that entitles the owner to receive a share of the profits and to share in the assets on dissolution;

"voting share" means a share in the capital of a corporation to which is attached a voting right ordinarily exercisable at meetings of shareholders of the corporation and to which is ordinarily attached a right to receive a share of the profits, or to share in the assets of the corporation on dissolution, or both.

73. Section 28 (1) of Investment Canada:

Acquisition of Control Rules

For the purposes of this Act, a non-Canadian acquires
control of a Canadian business only by

(a) the acquisition of voting shares of a corporation incorporated in Canada carrying on the Canadian business;
(b) the acquisition of voting interests of an entity that
   (i) is carrying on the Canadian business, or
   (ii) controls, directly or indirectly, another entity carrying on the Canadian business,
where there is no acquisition of control of any corporation;
(c) the acquisition of all or substantially all of the assets used in carrying on the Canadian business; or
(d) the acquisition of voting interests of an entity that controls, directly or indirectly, an entity in Canada carrying on the Canadian business, where
   (i) there is no acquisition of control, directly or indirectly, of a corporation incorporated elsewhere than in Canada that controls, directly or indirectly, an entity in Canada carrying on the Canadian business, or
   (ii) there is an acquisition of control described in subparagraph (i).

74. Section 28 (3) of Investment Canada:

Presumptions respecting acquisition of control

For the purposes of this Act,

(a) the acquisition of a majority of the voting interests of an entity or of a majority of the undivided ownership interests in the voting shares of an entity that is a corporation is deemed to be acquisition of control of that entity;
(b) the acquisition of less than a majority of the voting interests of an entity other than a corporation is deemed not to be acquisition of control of that entity;
(c) the acquisition of less than a majority but one-third or more of the voting shares of a corporation or of an equivalent undivided ownership interest in the voting shares of the corporation is presumed to be acquisition of control of that corporation unless it can be established that, on the acquisition, the corporation is not controlled in fact by the acquiror through the ownership of voting shares; and
(d) the acquisition of less than one-third of the voting shares of a corporation or of an equivalent undivided ownership interest in the voting shares of the corporation is deemed not to be acquisition of control of that corporation.
75. Section 14 of Investment Canada:

Review

(1) The following investments by non-Canadians are reviewable under this Part:

(a) an investment to acquire control of a Canadian business in any manner described in paragraph 28 (1)(a), (b) or (c), where the limits set out in subsection (3) apply;
(b) an investment to acquire control of a Canadian business in the manner described in subparagraph 28 (1)(d)(i), where the limits set out in subsection (3) apply;
(c) an investment to acquire control of a Canadian business in the manner described in subparagraph 28 (1)(d)(ii), where the circumstances described in subsection (2) and the limits set out in subsection (3) apply; and
(d) an investment to acquire control of a Canadian business in the manner described in subparagraph 28 (1)(d)(ii), where the circumstances described in subsection (2) do not apply and the limits set out in subsection (4) apply.

Circumstances

(2) The circumstances referred to in paragraphs (1)(c) and (d) are that the value, calculated in the manner prescribed, of the assets of the entity carrying on the Canadian business, and of all other entities in Canada, the control of which is acquired, directly or indirectly, amounts to more than fifty per cent of the value, calculated in the manner prescribed, of the assets of all entities the control of which is acquired, directly or indirectly, in the transaction of which the acquisition of control of the Canadian business forms a part.

Limits

(3) An investment described in paragraph (1)(a), (b) or (c) is reviewable under this Part where the value, calculated in the manner prescribed, of

(a) the assets acquired, in the case where control of a Canadian business is acquired in the manner described in paragraph 28(1)(c), or
(b) the assets of the entity carrying on the Canadian business, and of all other entities in Canada, the control of which is acquired, directly or indirectly, in the case where control of a Canadian business is acquired in the manner described in paragraph 28 (1)(a), (b) or (d), is five million dollars or more.
Limits

(4) An investment described in paragraph (1)(d) is reviewable under this Part where the value, calculated in the manner prescribed, of the assets of the entity carrying on the Canadian business, and of all other entities in Canada, the control of which is acquired, directly or indirectly, is fifty million dollars or more.

76. Section 11 (b) of Investment Canada:

Notification

The following investments by non-Canadians are subject to notification under this Part:

(b) an investment to acquire control of a Canadian business in any manner described in subsection 28 (1), unless the investment is reviewable pursuant to section 14.

77. Section 11 (a) of Investment Canada:

The following investments by non-Canadians are subject to notification under this Part:

(a) an investment to establish a new Canadian Business.

78. Section 8 (2)(a) of FIRA:

Notice of proposed establishment of new business

Every non-eligible person, and every group of persons any member of which is a non-eligible person, that proposes to establish a new business in Canada shall,

(a) if immediately before the time when the new business is proposed to be established no other business is carried on in Canada by that person or group of persons, give notice in writing to the Agency of such proposal in such form and manner and containing such information as is prescribed by the regulations.

79. Section 8 (2)(b) of FIRA:

Every non-eligible person, and every group of persons any member of which is a non-eligible person, that proposes to establish a new business in Canada shall,
(b) if each other business carried on in Canada by that person or group of persons immediately before the time referred to in paragraph (a) is a business to which the new business would, if it were established, be unrelated,

give notice in writing to the Agency of such proposal in such form and manner and containing such information as is prescribed by the regulations.

80. Section 37 (1) of Investment Canada:

Where any question arises under this Act as to whether an individual or an entity is a Canadian, the Minister shall, on application by or on behalf of the individual or entity, forthwith consider the application and any information and evidence submitted therewith and, unless the Minister concludes that the information and evidence submitted therewith is not sufficient to enable the Minister to reach an opinion on the question, shall provide the applicant with a written opinion for his guidance.

81. Section 17 of Investment Canada:

(1) Where an investment is reviewable under this Part, the non-Canadian making the investment shall, in the manner prescribed, file an application with the Agency containing such information as is prescribed.

(2) The application required by subsection (1) shall be filed

(a) subject to paragraph (b), in the case of an investment reviewable pursuant to section 14, at any time prior to the implementation of the investment;

(b) in the case of an investment made through an acquisition referred to in subparagraph 28 (1)(d)(ii) or an investment with respect to which a notice referred to in paragraph 16 (2)(a) has been sent, at any time prior to the implementation of the investment or within thirty days thereafter; or

(c) in the case of an investment reviewable pursuant to section 15, forthwith on receipt of a notice for review referred to in subparagraph 15 (b)(ii).


83. Ibid.

84. Ibid.
85. Section 19 (c) of Investment Canada:

The Agency shall refer to the Minister, for the purposes of section 21, any of the following material received by the Agency in the course of the review of an investment under this Part:

(c) any written undertakings to Her Majesty in right of Canada given by the applicant.


87. Ibid.

88. Ibid.

89. Ibid. See Also Watkins Report, pp. See Also Wahn Report, pp.

CHAPTER V


9. Ibid., para 8.
10. Ibid., para 9.
11. Ibid., para 11.
12. Ibid., paras 12, 13 and 15.
13. Ibid., para 14.
14. Ibid., paras 17, 18 and 19.
15. Ibid., paras 59 - 65.
16. Ibid., para 21.
17. Ibid., para 23.
18. Ibid., para 24.
19. Ibid., para 25.
20. Ibid., para 28.
21. Ibid., para 29.
22. Ibid., para 30.
23. Ibid., paras 33-35.
24. Ibid., para 37.
25. Ibid., para 38.
26. Ibid., para 39.
27. Ibid., para 40.
28. Ibid., paras 41-43.
29. Ibid., para 44.
30. Ibid., para 46.
33. Ibid., paras 67-69.
34. Ibid., para 71.


39. Ibid., p.28, para 84.

40. Ibid., p.29, para 85.

41. Ibid., p.26, para 74.

42. Ibid., p.26, para 75.


45. Ibid., pp.12-15; paras 24-34.

46. Ibid., pp.15-16, paras 38-41.

47. Ibid., p.16, para 39.

48. Ibid., para 41.

49. Ibid., p.17, paras 43-45.


51. Ibid., p.18, para 49. G.A. Resolution 626(VII) of 1952.


53. G.A. Resolution 1803 (XVII) of 14 Dec.1962, Section I(d).


55. Ibid., pp.21-22, para 56.

56. Ibid., p.22, para 58.


58. Ibid., para 62.

59. Ibid., para 63.
60. Ibid., p.24, para 66.
61. Ibid., p.25, para 70.
62. Ibid., pp.25-26, paras 72-73.
64. Ibid., Annex. IV, "Basis for a Concluding Document: Proposal By the Chairmen of Working Groups I & II". This has been referred to as Working Paper. Para 1(a).
65. Ibid., para 2.
66. Ibid., para 6.
67. Ibid., para 7.
68. Ibid., para 49.
69. Ibid., para 54.
70. Ibid., para 56.

CONCLUSION

2. Statements and Speeches No. 83/5. "An Address by the Hon. Gerald Regan, Minister of State (International Trade), to the Bankers' Association for Foreign Trade, San Juan, Puerto Rico, April 13, 1983.
3. Ibid.
4. Ibid.
5. Ibid.
SELECT READING

I. STATUTES

(i) Canadian
Foreign Investment Review Act, 1973-74
Investment Canada Act, 1985

(ii) Indian
Foreign Exchange Control Act, 1947
Foreign Exchange Regulation Act, 1973

II. U N DOCUMENTS

G.A. Resolution 35/56
G.A. Resolution 626 (vii)
G.A. Resolution 1803 (xvii)
TD/106
TD/134
TD/134/Supp.1
ST/ECA/190
ST/CTC/6
E/5209.
E/5500/Rev.1
E/C.10/38
E/C.10/62
E/C.10/79
E/C.10/84
EC/10/AC.2/18
E/1980/40/Rev.1 or E/C.10/75
E/1981/49 or E/C.10/92
E/C.10/1982/2
E/C.10/1982/6
E/C.10/1982/19 or E/1982/18
E/C.10/1983/S/2
E/C.10/1983/S/5 or E/1983/17
III. BOOKS AND ARTICLES


Canada - Administration of the Foreign Investment Review Act, Report of the Panel, General Agreement on Tariffs and Trade, L/5504.


Escorts Ltd. and Another vs. Union of India and Others, 57 Reports of Company Cases, 1985, 241-440.


Hundred per cent Export Units: Facilities and Incentives, New Delhi, Indian Investment Centre, 1984.


Kidron, Michael, Foreign Investments in India, Oxford University Press, 1965.


Myths and Realities of Foreign Investment in India, Indian Investment Centre, New Delhi.


Paterson, R.K.


Stairs, Denis and Gilbert R. Winham, research coordinators, *Canada and the International Political/Economic Environment*, University of Toronto Press, 1985.


APPENDIX I

LIST OF INDUSTRIES INCLUDED IN APPENDIX I TO GOVERNMENT PRESS NOTE DATED 2.2.1973 AS AMENDED SUBSEQUENTLY ON 21.4.1982:

1. Metallurgical Industries
   1. Ferro alloys.
   2. Automotive castings, SG iron castings, steel castings and steel forgings.
   3. Non-ferrous metals and their alloys, including aluminium foils.

2. Boilers and Steam Generating Plants.

3. Prime Movers (Other than Electrical Generators)
   1. Industrial turbines.
   2. Internal combustion engines.
   3. Alternate energy systems like solar, wind etc. and equipment therefor.
   4. Gas/hydro/steam turbines from 20 MW to 60 MW.

4. Electrical Equipment
   1. Equipment for transmission and distribution of electricity including power and distribution transformers, power relays, HT-switch gear synchronous condensers.
   2. Electrical motors.
   3. Electrical furnaces including industrial furnaces.
   4. X-ray equipment.
   5. Electronic components and equipment.
   7. Hydro/steam/gas generators from 20 MW to 60 MW.

5. Transportation
   1. Mechanised sailing vessels upto 10,000 DWT including fishing trawlers.
   2. Ship ancillaries.
   3. (1) Commercial vehicles, public transport vehicles including automotive commercial three wheeler jeep type vehicles, industrial locomotives.
      (2) Personal transport vehicles;
         (i) Passenger cars;
         (ii) Automotive two-wheelers, and three wheelers.
         Regarding two wheelers, on expansion of
existing units, subject to an export obligation of 25% on additional capacity.

(3) Specialised automotive components, such as pistons and piston rings, fuel injection equipment; auto electricals, such as starter motors, generators, spark plugs, rear axle assembly, brake and clutch assembly, tyre/tube valves, wheels, for automobiles and bimetal bearings.

6. Industrial Machinery

Industrial machinery including specialised equipment.

1. High performance and high fidelity industrial valves as may be specified by the Ministry of Industry.
2. Centralised lubrication systems:
4. Rolls for paper mills, rolls for rolling mills.
5. Pollution control equipment.

7. 1. Machine tools, including controls and accessories.
     2. Jigs, fixtures, tools and dies of specialised types and cross land tooling.
     3. Engineering production adis such as cutting and forming tools, patterns and dies and mining tools.

8. Agricultural Machinery

Tractors.

9. Earth-Moving-Machinery

Earth Moving machinery and construction machinery and components thereof.

10. Industrial Instruments

Indicating, recording and regulating devices for pressure, temperature, rate of flow, weights, levels and the like.

11. Scientific and Electromedical Instruments and Laboratory Equipment.

12. Nitrogenous and Phosphatic Fertilisers falling under

   (1) Inorganic fertilizers under '18-Fertilizers' in the
       First Schedule to the I (D&R) Act, 1951.

13. Chemicals (other than fertilizers)

   1. Heavy organic chemicals including petrochemicals.
   2. Heavy inorganic chemicals.
3. Organic fine chemicals.
4. Synthetic resins and plastics.
5. Man-made fibres.
7. Industrial explosives.
8. Technical grade insecticides, fungicides, weedicides and the like.
9. Synthetic detergents.
10. Miscellaneous chemicals (for Industrial use only) including--

   2. Photographic chemicals.
   3. Rubber chemicals.
   4. Polyols.
   5. Isocyanates, Urethanes etc.
   6. Speciality chemicals for enhanced oil recovery.
   7. Heating fluids.
   8. Coal tar distillation and products therefrom.
   9. Tonnage plants for the manufacture of industrial gases.
   10. High altitude breathing oxygen/medical oxygen.
   12. Refrigerent gases like liquid nitrogen, carbon dioxide, etc. in large volumes.
   13. Argon and other rare gases.
   15. Leather chemicals and auxiliaries.

14. Drugs and Pharmaceuticals

For FERA Drug Companies

(a) Drug intermediates from the basic stages for production of high technology bulk drugs.
(b) High technology bulk drugs from basic stages and formulations based thereon with an overall ratio of bulk drug consumption (from own manufacture to formulations from all sources of 1:2).

For non-FERA MRTP Companies

All bulk drugs and formulations with an overall ratio of 1:10 between the value of production of bulk drugs and formulations.

15. 1. Paper and Pulp including paper products.
     2. Industrial laminates.

16. 1. Automobile tyres and tubes, including automobile tyre tube valves.
2. Rubberised heavy duty industrial beltings of all types.
3. Rubberised conveyor beltings.
4. Rubber reinforced and lined fire fighting hose pipes.

17. Plate Glass
   1. Float Glass.
   2. Toughened glass insulators.
   3. Glass fibres of all types.

18. Ceramics.
   1. Refractories.
   2. Furnace lining bricks-acidic, basic and neutral.
   3. Ceramic fibres.

19. Cement Products
   1. Portland cement.
   2. Gypsum boards, wall boards and the like.


21. Carbon and Carbon Products
   1. Graphite electrodes and anodes.
   2. Impervious graphite blocks and sheets.

22. Pretensioned High Pressure RCC Pipes.

23. Rubber Machinery.

24. Printing Machinery.
   1. Web-fed high speed offset rotary printing machines having output of 30,000 or more impressions per hour.
   2. Photo composing/type setting machines.
   3. Multi-colour sheet-fed offset printing machines of sizes 18" x 25" and above.
   4. High speed Rotogravure printing machines having output of 30,000 or more impressions per hour.

25. Soya Products
   1. Soya Texturised Proteins.
   2. Soya Protein Isolates.
   4. Other Specialised products of Soya Bean.
   5. Winterised and Deodorised Refined Soya Bean Oil.

NOTE :: Items of manufacture reserved for the public sector under Schedule-A to the Industrial Policy Resolution, 1956 or for production in the small scale sector, as may be notified from time to time, will be excluded from the application of the list.
APPENDIX II

PRESS NOTE ON 'PROMOTION OF INVESTMENT FROM OED COUNTRIES'

(Press Note issued by the Ministry of Finance, Department of Economic Affairs, Government of India on 28 Oct., 1980)

Suggestions have been received from time to time that the Government of India could create additional facilities to promote investment in the country from Oil Exporting Developing Countries. These countries have large financial resources. However, opportunities for investment within their own countries are relatively limited and they look for investment opportunities outside. There is also the policy that Developing Countries could cooperate among themselves in a mutually beneficial manner.

2. Foreign Investment has been viewed by the Government of India as a vehicle for transfer of technology not indigenously available or to promote export oriented production. While Oil Exporting Developing Countries have substantial surplus financial resources, they may not have the type of technology which the country needs. It is, therefore, decided that foreign investment proposals from these countries need not be associated with transfer of technology from the equity holder and that such investments may be of a portfolio nature. The idea is that many priority areas like fertilisers, cement, Petrochemicals, paper and pulp etc. involve large financial outlays and growth of these sectors could reduce import dependence. In some ventures, there would be scope for export-oriented production catering either to the Oil Exporting Developing Countries or to other countries in Europe etc. The scope for raising foreign currency loans as a result of such a cooperation has also been taken into account by the Government.

3. Within the framework of the investment policy of the Government, it has been decided to provide the following facilities:

(a) Investment from oil exporting developing countries may be permitted in new companies even if it is in the nature of portfolio investment.

(b) Such investments should not exceed 40 per cent in the equity.

(c) The new companies should be export-oriented or should undertake manufacturing activities covered under Appendix I of the Industrial Policy of 1973.

(d) Investment on the aforesaid pattern may be allowed in hotels.
(e) Investment may also be allowed in new hospital project and such hospitals should have adequate provision for outdoor and emergency medical service to the general public and also for a minimum percentage of occupancy by Indian public.

(f) Loans should also be allowed to be raised abroad for such joint ventures provided the terms are reasonable.

4. Applications seeking to promote Indian ventures availing of these facilities may be made to the Secretariat for Industrial Approvals in the Ministry of Industry and all such applications will be decided by the Project Approval Board in a composite manner.