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THE PROTECTION OF INTERNATIONAL INVESTMENT AT THE START OF THE TWENTY-FIRST CENTURY: WILL ANACHRONISTIC NOTIONS OF BUSINESS RENDER IRRELEVANT THE OECD'S MULTILATERAL AGREEMENT ON INVESTMENT?

MICHAEL P. AVRAMOVICH*

INTRODUCTION

International trade and international investment are the twin pillars of the modern economic world. Investment inflows increased by 9 percent in 1994 to \$226 billion and by another 40 percent in 1995 to a record \$315 billion.¹ Investment outflows also reached a new record high during 1995 of \$318 billion, an increase of 38 percent over 1994.² In fact, the growth of foreign direct investment ("FDI") during 1995 exceeded that of exports of goods by 18 percent, world output by 2.4 percent and gross domestic capital formation by 5.3 percent.³ Although flows of direct investment to and from Organization for Economic Cooperation and Development countries fell slightly in 1996 from the previous year's level, 1996 figures for investment flows were still the second highest on record.⁴ The importance of international trade and investment

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1. UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, WORLD INVESTMENT REPORT 1996, (1996), at 3 [hereinafter WORLD INVESTMENT REPORT 1996].

2. *Id.*

3. The 1995 data for exports of goods are World Trade Organization estimates; those for world output are United Nations estimates; and gross domestic capital formation data are estimates for OECD member states only. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 3.

4. Organisation for Economic Co-Operation and Development, *Recent*

continues to grow as the nature of business evolves at the advent of the twenty-first century.

With the close of World War II, there was a clear recognition that the "beggar-thy-neighbor" trade policies of the 1930s significantly contributed to the start of the war.⁵ That recognition led to the beginnings of the General Agreement on Tariffs and Trade ("GATT") in 1947. Under GATT, participating countries agree to three basic principles: (1) nondiscrimination in trade through unconditional most-favored-nation treatment; (2) tariff reductions

Trends in Foreign Direct Investment, 67 FINANCIAL MARKET TRENDS 15, 15 (1997).

5. As one commentator has observed:

As a result of [Smoot-Hawley Tariff] legislation, average ad valorem rates on dutiable imports rose from 25.9 percent over the period 1921-25 to 50.02 percent between 1931 and 1935. A contemporary British economist at the time described ratification of the tariff as "a turning point in world history," for it brought with it the collapse of the international gold standard. . . .

Retaliation by other countries to the Smoot-Hawley Tariff followed almost immediately upon its adoption and brought with it the collapse of world trade. American exports fell faster than imports as the rest of the world jockeyed for a competitive edge via tariffs or other trade restrictions. Whereas in 1929 U.S. net exports had amounted to \$842 million, by 1933 they were only \$225 million or about one-third of the pre-tariff war, predepression level of trade.

JEREMY ATTACK & PETER PASSELL, *A NEW ECONOMIC VIEW OF AMERICAN HISTORY* 600-01 (2d ed. 1994) (footnotes and table references omitted).

The implementation of the Smoot-Hawley Tariff illustrates the importance of the economic policies on international political issues that can lead to war. One commentator said:

The most disastrous single mistake any U.S. president has made in international relations was Herbert Hoover's signing of the Smoot-Hawley Tariff Act into law in June 1930. The sharp increase in U.S. tariffs, the apparent indifference of the U.S. authorities to the implications of their actions for foreigners, and the foreign retaliation that quickly followed, as threatened, helped convert what would have been otherwise a normal economic downturn into a major world depression. The sharp decline in foreign trade and economic activity in turn undermined the position of the moderates with respect to the nationalists in Japanese politics and paved the way for the electoral victory of the Nazis in Germany in 1932. Japan promptly invaded China in 1931, and the basis for World War II was laid.

Valuable lessons were learned from the Smoot-Hawley tariff experience by the foreign policy community: the threat of tariff retaliation is not always merely a bluff; tariffs do influence trade flows negatively; a decline in trade can depress national economies; economic depression provides fertile ground for political radical nostrums; and political radicals often seek foreign (military) adventures to distract domestic attention away from their domestic economic failures. The seeds of World War II, in both the Far East and in Europe, were sown by Hoover's signing of the Smoot-Hawley tariff.

RICHARD N. COOPER, *U.S. TRADE POLICIES IN A CHANGING WORLD ECONOMY* 291-92 (Robert M. Stern ed., 1987), reprinted in JOHN H. JACKSON ET AL., *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS* 38 (3d ed. 1995).

through a series of multilateral negotiations and agreements; and (3) the elimination of most import quotas.⁶ The GATT system has succeeded in lowering tariff barriers on imported goods by average reductions from approximately 40 percent to approximately 3 percent in participating nations.⁷

At present, treaty protection for investment is less effective than treaty protection for trade. A number of economists consider FDI to be encompassed by international trade theory; others argue that the time has come for a multilateral agreement on FDI. This thesis recognizes that certain existing bilateral and multilateral agreements, and in particular, the North American Free Trade Agreement ("NAFTA"), provide private rights to foreign investors giving them the opportunity to challenge injurious host-state conduct in a formal dispute settlement system. However, none sufficiently addresses the current nature of investment. Even NAFTA falls short. Inherently limited as a regional agreement with only three member states, NAFTA limits the right to adequate compensation to expropriation. It does not allow a foreign investor to seek money damages for either establishment or post-establishment treatment. As one commentator has observed, in most countries the legal basis for government actions against foreign private property derives from the Second World War, and in the United States from approximately 1917.⁸ The legal basis for actions of economic warfare lies in the international conflicts of the past.⁹

This thesis considers how the shift in the manner in which business will be done in the future is as different from the post-World War II world as the Industrial Revolution was from the Feudal Age in Europe. Although wealth creation will increasingly be undertaken through the development of information processing networks, recent bilateral and multilateral investment treaties have presumed business structures consistent with anachronistic business practices. This thesis concludes by observing that the Multilateral Agreement on Investment ("MAI") currently under

6. ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 5-6 (1993).

7. For example, in the United States, as a result of eight series of international trade negotiations, the ratio of duties collected to dutiable imports declined as follows:

1941(after Trade Agreements Act of 1934)36.8%

1951(after formation of GATT)12.3%

1961 12.1%

1971(after Kennedy Round) 9.0%

1981(after Tokyo Round) 4.9%

1991 5.1%

JACKSON ET AL., *supra* note 5, at 5 tbl.1.1.

8. WALTER KOLVENBACH, PROTECTION OF FOREIGN INVESTMENTS 3 (1989).

9. *Id.*

negotiation by the Organization for Economic Cooperation and Development ("OECD")¹⁰ in Paris, and particularly its investor-to-state dispute settlement mechanisms, must embrace the ongoing transformation of business. Rapid changes in communications and computer technology, and the concurrent changes in social structure, necessitate that dispute settlement under the MAI must (1) encompass any alleged violation of the MAI with respect to both establishment and post-establishment treatment, (2) include a definition of "investment agreement" broad enough to accommodate the increasing profusion of business structures seen today, and (3) incorporate a more complete view of asset-based investment, consistent with the recognition of a broader understanding of assets in a knowledge-based economy. Failure to do so may render the MAI obsolete from the outset, and OECD negotiators will have missed an opportunity to develop legal protection for what could be an unparalleled burst of economic and entrepreneurial activity.

I. BUSINESS AT THE ADVENT OF THE TWENTY-FIRST CENTURY WILL INCREASINGLY CREATE WEALTH THROUGH THE ENTERPRISING USE OF INFORMATION PROCESSING NETWORKS, RATHER THAN THROUGH ARCHAIC MODELS OF INVESTMENT ROOTED IN THE INDUSTRIAL REVOLUTION.

Wealth was created in the Industrial Revolution by bringing together a number of factors, including (a) the high technology of the era, (b) the accumulation of large amounts of capital that was invested in one place, and (c) an abundance of unskilled labor.¹¹ Profitability in the Industrial Revolution was based upon the mass production of industrial and consumer products at the lowest possible cost.¹² By constantly focusing attention on costs, management could maximize an enterprise's profits.¹³ A corollary of the Industrial Revolution's management technique was that, in order to produce large quantities of products, an enterprise had to grow by whatever means possible.¹⁴ That led to the formation of numer-

10. The OECD was established in 1961. As of April 1997, the following states were members of the OECD: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

11. 9 THE NEW CAMBRIDGE MODERN HISTORY 31-47 (C.W. Crowley ed., 1965).

12. 6 THE CAMBRIDGE ECONOMIST HISTORY OF EUROPE 451-54 (H.J. Habakkuk & M. Postan eds., 1965).

13. *Id.*

14. See ATACK & PASSELL, *supra* note 5, at 474-81 and accompanying tabular data for illustrations of industrial growth.

ous trusts in the industrial and commercial sectors.¹⁵ Some of those trusts were international in scope.¹⁶ Economist Ronald Coase presented the classic explanation of why the large, integrated corporation came to predominate the business world.¹⁷ He argued that such companies were justified by the "transactions costs" savings that resulted from combining smaller operations into larger ones.¹⁸ Those savings come in a variety of ways, such as reductions in legal and administrative costs, as well as any "excess profits" accruing to "middlemen."¹⁹

The enactment of the Sherman Antitrust Act in 1890, though slowing the pace of business management toward the formation of trusts, did little to limit multinational expansion or to "hinder the dramatic wave of consolidations that took place around the turn of the century despite the degree of economic concentration many of them entailed."²⁰ However, it was not until after World War II that the world's largest manufacturing firms were transformed from national firms into multinational enterprises through the development of extensive networks of subsidiaries and affiliates outside of the home country.²¹ International expansion accelerated during the 1960s, principally among American firms, although other companies headquartered from the Far East through Europe also extended the reach of their international operations.²² The expansion of such multinational companies contributed greatly to direct links that increasingly integrated national economies with one another.²³ Improvements in the speed of travel and communications, and the ubiquity and power of computer technology, coupled with the development of new uses of computer technology such as the Internet, have changed the basis of wealth creation in today's world.

Consider, for example:

On a late summer afternoon in 2002, Angelo Punturi relaxes on a sunny beach at Taormina, Sicily, with two favorite books: *Paideia*, by Werner Jaeger and *The Waning of the Middle Ages*, by Johann Huizinga. He reflects on the changes that have occurred since the times depicted in those two classics. He contemplates how the ideals of classical Greek culture described in *Paideia* have influenced intellectual life and history up to his day. He considers

15. *Id.* at 481-88.

16. *Id.* at 489.

17. Ronald H. Coase, *The Nature of the Firm*, *ECONOMICA*, 386-405 (1937).

18. *Id.*

19. *Id.*

20. ATACK & PASSELL, *supra* note 5, at 488.

21. Raymond Vernon, *Multinationals are Mushrooming*, in *INTERNATIONAL ECONOMICS AND INTERNATIONAL ECONOMIC POLICY: A READER* 220, 220 (Philip King, ed. 1990).

22. *Id.*

23. *Id.* at 220-21.

how the technological, economic and other social changes discussed in the *Waning of the Middle Ages* were influenced by the end of one historical era and the beginning of another. He wonders whether, just as he longs for the sense of community and *polis* of earlier eras, others must long for the same. There must be many other people curious about such developments and interested in experiencing or even reliving life in such a time. He decides that he will create a business to enable people to live in such a world, at least temporarily. Imagine if people could converse about major issues with Plato and Aristotle, listen to speeches by Pericles on the issues of his day, and observe the military training of the youth in Sparta. Why, millions would wish to participate in such an adventure, reasons Punturi. Rather than investing billions of dollars to create "Ancient Greece" in a fixed location, Punturi decides he can create a more powerful experience for participants at significantly less cost if he uses virtual reality technology to re-create the ancient Greek academy. Through his computer, Punturi has his new company, Ancient Greece Organization for the Recreation of the Academy ("AGORA"), incorporated in one hour in the Bahamas, after examining a number of other possible locations.²⁴ Financial instructions place AGORA's liquid assets in a cyberaccount in a cyberbank domiciled simultaneously in Newfoundland, the Cayman Islands, the Isle of Man, Zambia and Switzerland. Before undertaking the project, Punturi canvasses the current contract offers of protection for software design and manufacturing facilities in a variety of jurisdictions, including the United States, Bangladesh, Padania, Andorra, Israel and Hunan. Information-retrieval systems available through his computer automate the selection of contract provisions, employing artificial intelligence processes to customize private contracts for transnational legal conditions. Punturi ultimately lets out bids to a number of suitable designers and manufacturers, and begins distribution of the virtual reality technology. Through the use of cybercommerce, transactions occur outside the jurisdiction of nation-states. Payments are made in cybercurrency, profits are

24. When this thesis was begun, AGORA was added as an illustration of where technology might be in the future. The future arrived while this thesis was being drafted. The March 20, 1997 edition of *The Wall Street Journal* report on "Willisville":

offer[ed] a peek at the kind of immersive, 3-D worlds the Internet could one day offer to entertain visitors. Unlike "episodic," or storytelling, sites, which allow no more than e-mail feedback from viewers, Willisville is a 24-hour virtual community that on-line users can become part of. By "uploading" their own images, music and text, visitors can walk down the streets and into the stores and homes of the town's fictional characters, engaging in dialogue or otherwise becoming actors in a collision of high-tech and soap-opera kitsch.

Lisa Bannon, *Another World*, WALL ST. J., Mar. 20, 1997, at R11.

booked in cyberbanks. From his profits, Punturi makes investments through a network of cyberbrokerages. Most transactions will not be subject to taxation. When Angelo Punturi returns to the beach several months later with other books, he thinks about how the powers of government over traditional areas of the economy will be transformed by the new logic of the cybereconomy, just as the economic changes in the Middle Ages led the way to the Renaissance.

A. Profitability Will Flow to Networks of Intellectual Capital.

As noted above, wealth creation previously required the harnessing of technology through the accumulation of large amounts of capital that was invested in property, plant and equipment.²⁵ The cash flows from established operations permitted industrial research within larger corporations based upon a product's "life cycle." As older products declined, reinvesting cash flows in the associated production processes no longer paid. The excess cash flow was channeled into research and development of new products, which ensured ongoing revitalization of the corporation.²⁶

In an industrial society, the strategic resource was capital: although many persons may have known how to build a factory, few had the money to do so. Consequently, access to wealth creation opportunities was limited.²⁷ Today, wealth creation is being realized through the application of intellectual capital to solving problems and creating value.²⁸ Knowledge is supplanting large-scale,

25. See *supra* notes 11-16 and accompanying text for a discussion of wealth creation during the industrial revolution.

26. See DAVID K. EITEMAN & ARTHUR I. STONEHILL, *MULTINATIONAL BUSINESS FINANCE* 470-72 (5th ed. 1989), for a discussion and examples of the product life cycle as applied to FDI.

27. In a recent book excerpt in *FORTUNE* magazine, Thomas A. Stewart remarked:

The logic of [early] capitalism was simple. Mr. Moneybags got an idea for a business. He turned his money, plus some from a bank, into fixed assets—a factory, machines, offices. He hired a Man in a Gray Flannel Suit to manage the assets. The manager, in turn, hired workers to operate the machines. Moneybags paid them—hourly wages to the easily replaceable workers, annual salaries to the managers, a reflection of their longer-term value. Moneybags kept all the profits; he was also responsible for paying the bank, maintaining the machines, and buying new ones. He might offer the public a chance to share ownership with him; occasionally he gave managers the option to buy a piece too. He almost never let the workers in on the action, though in good years he gave them a goose for Christmas.

... Henry Ford owned everything needed to make cars and owned the cars themselves, until he sold them. Then the customer took sole possession.

THOMAS A. STEWART, *INTELLECTUAL CAPITAL* (1997) excerpted in Thomas A. Stewart, *Brain Power*, *FORTUNE*, Mar. 17, 1997, at 105, 105.

28. Stewart identifies how the transition to intellectual capital, rather than

concentrated investment in property, plant and equipment as the principal strategic resource. As Peter Drucker stated, "The productivity of knowledge has already become the key to productivity, competitive strength, and economic achievement. Knowledge has already become the primary industry, the industry that supplies the economy the essential and central resources of production."²⁹

The shift from an industrial society to an information society is a revolution. One commentator has described the transition as follows:

[W]hen new technologies tip the balance [away from large corporations and] toward smaller, more flexible organizations, once cost-effective management hierarchies become an unnecessary burden. And new technologies in manufacturing, information handling, and communications are indeed shifting the balance between hierarchies and markets.³⁰

Unlike traditional hard assets, knowledge is not subject to the law of conservation. It can be created, it can be destroyed, and, most importantly, it is synergetic; that is, the whole is usually greater than the sum of the parts. With the coming of the information society, for the first time the key economic resource is not only renewable but self-generating. Knowledge is an asset that can strengthen with experience, rather than depreciate.

brick and mortar, is changing both the nature and governance of corporations. He observes:

Intellectual capitalism is different. In knowledge-intensive companies, it's not clear who owns the company, its tools, or its products. Moneybag's modern-day descendant starts with seed money from a Silicon Valley venture capitalist. He leases office space in some Edge City corporate village and doesn't own a factory; a company in Taiwan manufactures his products. The only plant and equipment the company owns are computers, desks, and a 1950s Coke machine someone picked up at auction. Whereas Moneybags bought the assets of his company, it is unclear who makes the investments on which intellectual capitalism depends, the investments in people. The manager—the Man in the Ralph Lauren Polo Shirt—paid his own way through business school. The worker is shelling out for an electronics course she takes at night, though the company will reimburse her for half the cost when she completes it. Every manager and worker receives stock options—as a group they may own as much stock as the capitalists.

. . . [I]n the age of intellectual capital, the most valuable parts of [many] jobs are the human tasks: sensing, judging, creating, building relationships. Far from [a Marxian view where the industrial worker is] alienated from the tools of his trade and the fruit of his labor, the knowledge worker carries them between his ears. . . . Employees, companies, and customers share joint and several ownership of the assets and output of knowledge work.

Id.

29. JOHN NAISBITT, MEGATRENDS 16-17 (1982).

30. John W. Kensinger & John D. Martin, *Financing Network Organizations*, in THE NEW CORPORATE FINANCE 561 (Donald H. Chew, Jr. ed., 1993).

In addition, unlike traditional hard assets, networks of intellectual capital have become much more important to the wealth of increasingly large numbers of companies. In the Senate Judiciary Committee Report recommending the enactment of the Economic Espionage Act of 1996,³¹ an act that criminalizes the theft of proprietary information and trade secrets, the Committee stated:

In the last few decades, intangible assets have become more and more important to the prosperity of companies. A recent analysis by the Brookings Institute indicates that in 1982, the tangible assets of mining and manufacturing companies accounted for 62 percent of their market value. By 1992, they represented only 38 percent of the market value. As this Nation moves into the high-technology, information age,³² the value of these intangible assets will only continue to grow.

The increasing importance of intangible assets is not limited solely to property that is a "right" such "as a patent, copyright, or trademark, . . . or one which is lacking physical existence, such as goodwill."³³ As observed in a 1996 *Fortune* survey of America's most admired corporations:

[T]o be genuinely admired, an ineluctable quality must be in the mix as well: a spark that ignites the work force and allows the enterprise to respond readily to change. That ingredient is innovation, and all the top companies embrace it passionately.

Innovation abounds at ever-fertile 3M Corp., which introduced 500 new products last year. It's the force behind Pfizer, now known for having the best pipeline of new drugs coming to the market. It's what galvanizes Intel, whose brilliant new microprocessors keep driving the world's voracious appetite for computers.

It's not just manufacturers that win reputations for delivering creativity, either. Enron, a very different kind of power company, and Mirage Resorts, a dazzling collection of Las Vegas gambling casinos were ranked first and second for innovation among all 431 companies in this year's list. Even Coca-Cola, which has made nearly all its fortune from a single unvarying product for more than a century is relentlessly innovative.

But that raises the question: Just what is innovation? It isn't necessarily frizzy-haired scientists in white lab coats, though too many people think it is. Says Douglas Ivester, chief operating officer at Coke: "Everybody falls into the trap of looking at the latest gadget, or thinking that creativity has to be in the arts and sciences. But you've got to encourage creativity in staffing, strategy, branding,

31. S. REP. NO. 104-359 (1996).

32. *Id.* at 6 (citations omitted).

33. Definition of "intangible asset." BLACK'S LAW DICTIONARY 808 (6th ed. 1990).

and business processes too." You might say then, then, that innovation is a style of corporate behavior that's comfortable with, even aggressive about, new ideas, change, risk and failure. And it must permeate a very wide swath of an organization to make a difference.³⁴

General Electric, the most admired company in *Fortune's* 1998 list, is "huge, nimble, and immensely profitable."³⁵ Under its Chairman, Jack Welch, General Electric spends upwards of \$800 million a year on training and leadership development, which is focused on "how to anticipate change, how to cope with change, how to change a very big company that does many things well."³⁶ That investment in training and leadership development represents approximately one half of what General Electric spends yearly on research and development.³⁷ General Electric's net income for 1997 totalled \$8,203 million.³⁸ Investors have recognized the value of General Electric's management and operations. On March 18, 1998, the total stock market valuation of General Electric was \$260,147.2 million dollars.³⁹ Coca-Cola, the third most admired company in *Fortune's* 1998 list, also brings its commitment to innovation to fruition in its strong financial performance. During 1996, for example, eighty percent of Coca-Cola's profits came from foreign markets, with strong growth in Latin America, Eastern Europe and China.⁴⁰ Coca-Cola's net profit for 1997 totalled \$4.129 million.⁴¹ Investors also have recognized the value of its achievements. On March 14, 1998, the total stock market valuation of Coca-Cola was \$184,861.7 million, a 4,641 percent increase from its stock market valuation sixteen years ago, on March 12, 1982, of \$3.9 billion.⁴²

However, it is particularly in the high-technology firms that one sees the clearest evidence of how networks of intellectual capital have become more important to the prosperity of companies; a prosperity in which investors completely disconnect the value of tangible assets from the fair market value of the enterprise as a

34. Brian O'Reilly, *The Secrets of America's Most Admired Corporations: New Ideas, New Products*, FORTUNE, Mar. 3, 1997, at 60, 60.

35. Thomas A. Stewart, *America's Most Admired Companies*, FORTUNE, Mar. 2, 1998, at 70, 73.

36. *Id.* at 80.

37. *Id.*

38. Nelson D. Schwartz, *A Downshift in Profit Growth*, FORTUNE, Apr. 27, 1998, at F-1.

39. *Id.* at F-2.

40. Andrew Leckey, *A Refreshing Investment: Coca-Cola Continues to Show Strong Growth Internationally*, CHI. TRIB., Feb. 17, 1997, § 6, at 7.

41. Schwartz, *supra* note 38, at F-3.

42. Information compiled from data provided by Melanie Warner, *The Fortune 500: Size Matters*, FORTUNE, Apr. 28, 1997, at 201; Schwartz, *supra* note 38, at F-4.

going concern. For example, in 1996, Microsoft and Intel had a combined stock-market value that exceeded the combined market value of General Motors, Ford Motor, Boeing, Eastman Kodak, Sears Roebuck, J.P. Morgan, Caterpillar and Kellogg by almost \$10 billion.⁴³ Moreover, the scope of the disconnect between the value of tangible assets from the fair market value of the enterprise as a going concern is immense. One way to glimpse the scope of issue is to look at the difference between the fixed assets and the market value of the 500 companies that make up the Standard and Poor's Stock Price Index. At the end of December 1995, those 500 companies had fixed assets worth an estimated \$1.2 trillion, according to Standard and Poor's, but a combined stock market valuation of \$4.6 trillion.⁴⁴ The difference of \$3.4 trillion represents the value imputed by investors to the intangible assets and "networks of intellectual capital" in those firms, including such forms of capital as the company's ability to innovate, the capability and creativity of its work force, and an estimate to measure the enterprise's ability to respond readily to change, as compared with competitors in its field.

Moreover, with information as the strategic resource, access

43. John R. Dorfman, *Microsoft, Intel Take Over As the New Kings of Stocks*, WALL ST. J., Mar. 21, 1997, at C1. Dorfman quoted money manager Edward Macheski, who found the difference to be anomalous. Macheski observed:

[Both high-technology firms during 1996] have combined revenues of \$30.3 billion. . . . [The other eight firms in 1996] all traded on the New York Stock Exchange, have combined revenues of \$425.2 billion, or 14 times as much.

. . . [As to profits, Intel and Microsoft] had a combined profit of \$7.6 billion for the latest reported 12-month [1996] periods. The eight had combined profits of \$16.2 billion—more than twice as much.

Id. 1997 results for Intel and Microsoft showed combined revenues of \$36.4 billion, whereas the other eight firms in 1997 had combined revenues of \$389.7 billion, or 10.7 times as much. Intel and Microsoft's net income showed a combined profit of \$10.4 billion for the latest reported 12-month 1997 periods. The eight other companies had combined profits of \$20.2 billion, only 94% greater.

Schwartz, *supra* note 38 at F-1 to F-9.

Despite Macheski's observations, Dorfman states:

The explanation lies in growth rates. Earnings at Microsoft and Intel have been growing much faster than at the traditional companies. GM, Ford and the others . . . are mostly mature companies in cyclical industries whose ups and downs mean their peak earnings aren't valued as highly. Some of them, such as GM, Sears and Kodak in the past have had a reputation for weak or stodgy management as well.

By contrast, Microsoft and Intel hold the keys to the fast-growing personal-computer industry. Microsoft's earnings have grown about 36% a year for the past four years; Intel's have grown about 37% a year.

Dorfman, *supra*, at C1.

44. Randy Myers, *Getting a Grip on Intangibles*, CFO, Sept. 1996, available in LEXIS, News Library, Curnws File.

to the economic system is much easier. One no longer needs the capital to build a factory to tap opportunities for wealth creation. And tapping into those opportunities is itself easier. Combined technologies of the telephone, computer and television are increasingly merged into an information and communication system that transmits data and permits almost instantaneous interaction between persons and computers. One commentator has observed:

As our transportation network carried the products of industrialization in the past, so too will this emerging communications network carry the new products of the information society. This new integrated communication system will fuel the information society the way energy . . . kept the industrial society humming and the way natural power—wind, water, and brute force—sustained agricultural society.⁴⁵

Investors are increasingly drawn to companies involved in such emerging technologies. To illustrate, Internet stocks, AOL, Yahoo, Excite, and Amazon.com, have all at least tripled in value from 1997 through early 1998.⁴⁶ One commentator notes, "The Net's growth prospects are so huge and so open-ended, and the Internet is evolving so quickly, that ordinary valuation measures don't apply."⁴⁷

Business increasingly will move from centralized hierarchical structures toward decentralized networks of functions. Such "networks of intellectual capital" seek to free and develop the human talent within their organizations in two ways. First, employees use what they know in a more effective and efficient manner.⁴⁸ Second, employees develop information and experience in the areas most useful to the organization.⁴⁹ Today's use of computer and communication technology hastens the development of networks of intellectual capital capable of creating greater wealth because the armies of middle-level managers, clerks and other similarly employed persons engaged in the nonproductive tasks of paper shuffling are increasingly redundant. Moreover, the need to release the human talent within an organization brought on by global competition compels the elimination of menial tasks, tedious paperwork and unproductive political infighting.⁵⁰

The hypothetical Punturi's AGORA describe *supra* is an example of a pure "network of intellectual capital." Not every business concern lends itself to a pure network, but partial shifts can and have already occurred. The American automobile industry, once the textbook model of vertical integration, now outsources an

45. NAISBITT, *supra* note 29, at 24.

46. Andrew Serwer, *Street Life*, FORTUNE, Apr. 13, 1998, at 191, 191.

47. *Id.*

48. Stewart, *supra* note 27, at 106.

49. *Id.*

50. *Id.*

increasing share of its parts production.⁵¹ A team of computer software designers and engineers from India, the United States, Italy and Brazil, each working in his or her own country, together develops a successful software product that is sold worldwide.⁵² One commentator has observed:

[I]n the emerging high-value economy, [products can] . . . be combined in all sorts of ways to serve customer needs in many places. Intellectual and financial capital can come from anywhere, and be added instantly.

Consider some examples: Precision ice hockey equipment is designed in Sweden, financed in Canada, and assembled in Cleveland and Denmark for distribution in North America and Europe, respectively, out of alloys whose molecular structure was researched and patented in Delaware and fabricated in Japan. An advertising campaign is conceived in Britain; film footage for it is shot in Canada, dubbed in Britain, and edited in New York. . . . A jet airplane is designed in the state of Washington and in Japan, and assembled in Seattle, with tail cones from Canada, special tail sections from China and Italy, and engines from Britain.⁵³

A major telecommunications company outsources management of its real estate assets to another company.⁵⁴ A major accounting firm dispenses with its "one-cubicle-per-auditor" policy and institutes "hoteling": auditors must make reservations to use a limited number of office spaces when not in the field conducting audits.⁵⁵ Increasing numbers of employees telecommute.⁵⁶ Em-

51. As far back as 1986, commentators observed the evolution of a new kind of company: manufacturers that do little or no manufacturing. As one commentator said:

Indeed, U.S. manufacturers are pursuing a strategy of outsourcing—buying parts or whole products from other producers, both at home and abroad—with a vengeance. Outsourcing breaks down manufacturers' traditional vertical structure, in which they make virtually all critical parts, and replaces it with networks of small suppliers. . . . In the short run, the new system may be amazingly flexible and efficient. In the long run, however, some experts fear that such fragmented manufacturing operations will merely hasten the hollowing [out of American industry].

Norman Jonas, *The Hollow Corporation*, BUS. WK., Mar. 3, 1986, at 57, 58.

52. See, e.g., Michael Avramovich, Note, *Intercompany Transfer Pricing Regulations Under Internal Revenue Code § 482: The Noose Tightens On Multinational Corporations*, 28 J. MARSHALL L. REV. 915, 928 n.68 (1995) (illustrating this type of collaboration).

53. ROBERT B. REICH, *THE WORK OF NATIONS* 112 (1991).

54. J. Linn Allen, *Chicago Mecca for Real Estate Gurus*, CHI. TRIB., Sept. 3, 1996, § 3, at 1.

55. Leslie Helm, *The Fading Metropolis*, L.A. TIMES, June 3, 1996, at D1.

56. Mark Calvey, *Corporate Belt-Tightening Puts Squeeze on Office Luxuries*, SAN FRANCISCO BUS. TIMES, Oct. 18, 1996, available in LEXIS, News Library, Curnws File.

ployed and unemployed persons are exhorted to think of themselves not in terms of titles but as bundles of skills, to rearrange as the hologram of today's job market may dictate. Businesses reduce the numbers of employees and use temporary workers to staff by project, the personnel analogue of "just-in-time" inventory techniques.

B. Business Structures Will Evolve Into and Operate as New Forms.

New business structures will evolve and operate in the future as a result of the change to an information society. Some new forms of business organizations are already beginning to appear in addition to the shifts in existing business structures discussed *supra*. Competitive pressures will lead to an abundance of smaller firms that combine the advantages of the economy of scale of large corporations with the operational flexibility and customer responsiveness typical of smaller enterprises. The smaller firms may form strategic partnerships with other independent specialists.⁵⁷ Some forms will be tried and abandoned, others will be found to have disadvantages, and others for whatever reasons will be disapproved by governments.

Some new business structures are discussed below. Although it is not possible to predict the scope of business structures and arrangements that will come to predominate business in the next century, we can expect to see a wide range of creativity and innovation as businesses seek to create wealth consistent with the information society.

1. Technology Marketing Partnerships.

Technology marketing partnerships are business organizations formed for the purpose of bringing a specific product or group of products to market. The general partner may manufacture the product itself or contract the manufacturing to a third party. The general partner also contracts with third parties for advertising and promotion. The partnership owns the trademark and brand name supported by its advertising, and has an exclusive distributorship for the product. It earns revenues from royalties or commissions paid out of sales by the manufacturer. In some cases they are set up with an option for the manufacturer to buy out the distributorship for a lump sum.

For example, Lewis Galoob Toys, makers of Star Wars and Micromachines toys, can draw upon independent inventors for new designs and arrange for production by "partner" contractors in

57. See Russell Johnston & Paul Lawrence, *Beyond Vertical Integration—the Rise of the Value-Adding Partnership*, HARV. BUS. REV., July-August 1988, at 94 (detailing the success of smaller value-adding partnerships).

Hong Kong, who pass on the most labor-intensive manufacturing to factories in China.⁵⁸ Galoob can then have goods on the shelves in cities across the United States within a matter of several weeks. To realize this global capability, Galoob relies on only 115 employees of its own.⁵⁹ Galoob is but one of many companies in toys, garments, electronics, sporting goods and other industries that are "vertically disaggregated": industrial companies without industrial production that rely on other companies for manufacturing and other business functions.⁶⁰ Such network companies are not entirely new. Publishers, clothing manufacturers, and construction companies have contracted out work for years.⁶¹

Technology marketing partnerships are not limited to industrial companies. For example, Idealab, founded by Bill Gross, is in the business of creating businesses.⁶² Since the beginning of 1996, Idealab has been developing Gross's business opportunity ideas into independent companies, each of which is currently Internet-related.⁶³ In February 1997, Idealab's nineteen businesses employed about 400 persons.⁶⁴ Idealab's "manufacturing" process is described as follows:

[I]ts assembly line is actually quite simple. Gross keeps a voluminous inventory of one raw material, ideas, in his cranium. People, the other raw material, are shipped in from the outside: Gross recruits CEO-caliber executives and hands each of them a promising business idea. Then the factory—Idealab's core staff of 15—helps them construct businesses around the ideas. It furnishes them with a little seed money (no more than \$250,000 per company), the pre-fab company structure, and expert assistance with design, marketing, and just about everything else. Off the end of the assembly line roll dozens of small, fast-moving, "incredibly highly focused" enterprises, according to Gross. Idealab retains a minority equity stake ranging from 25% to 49% in them.⁶⁵

Gross's vision was to nurture start-up companies through a network of "interdependent yet nominally independent companies, all built around a core base of knowledge . . . [that] leverag[ed] the [network's] shared creative and technical know-how."⁶⁶ Idealab may represent a present-day example of what may prove to be a successful model for the future. Idealab also demonstrates the in-

58. John W. Wilson and Judith H. Dobrzynski, *And Now, the Post-Industrial Corporation*, BUS. WK., Mar. 3, 1986, at 64, 64.

59. *Id.*

60. *Id.*

61. *Id.* See *id.* at 64-71, for more information on Lewis Galoob Toys and other post-industrial business networks.

62. Jerry Useem, *The Start-up Factory*, INC., Feb. 1997, at 40, 42.

63. *Id.*

64. *Id.*

65. *Id.* at 46.

66. *Id.*

creasing difficulty of categorizing the structure of a business in the twenty-first century:

Like a business incubator, it provides shared office space and administrative services for its brood. Like a venture-capital firm, it provides seed funding and takes a minority equity stake in the companies. Like a think tank, it brainstorms on technology applications that could form the basis for new products. And like a parent company, it takes a substantial role in overseeing the operations of its subsidiaries.⁶⁷

The advantages of such networks make them particularly valuable to investors. Networks can expand rapidly by adding new partners, but perhaps more importantly, they can also contract quickly and easily when a particular project is completed. At that point, the individual firms simply go their separate ways and enter new relationships in pursuit of further opportunities, even though the network may remain stable for many years. By contrast, large corporations often can grow quickly, but contract with the greatest of difficulty before redeploying resources to uses that generate greater returns.⁶⁸ In addition, network organizations reduce the often serious problems arising from the separation of ownership from control that can dissipate a great deal of managerial focus in larger corporations.⁶⁹ Senior management in networks typically have large equity stakes that provide significant incentives to invest capital when the returns are promising, but also to return that capital to investors when the expected returns fail to reach competitive levels.⁷⁰

2. *Spin-Outs and Equity Carve-Outs.*

Equity carve-outs "initiate[] public trading of the common stock of [a] previously wholly-owned subsidiary."⁷¹ Equity carve-outs enable investors to participate in corporate growth opportunities on a stand-alone basis.⁷² Therefore, "investors are attracted to subsidiary growth opportunities when these are isolated from the consolidated entity (that is, available for separate purchase)."⁷³ The origin of equity carve-outs is not new.⁷⁴ However, the impetus that accelerated the development of this new form of

67. *Id.*

68. GORDON DONALDSON, *MANAGING CORPORATE WEALTH* 3, 22 (1984).

69. Kensingler & Martin, *supra* note 30, at 563.

70. *Id.*

71. Katherine Schipper & Abbie Smith, *Equity Carve-Outs*, in *THE NEW CORPORATE FINANCE* 551, 556 (Donald H. Chew, Jr., ed., 1993).

72. *Id.* at 551.

73. *Id.*

74. Schipper and Smith reviewed the market-adjusted returns of 76 equity carve-out announcements by New York and American Stock Exchange companies over the period 1965-1983. *Id.* at 551 and n.1.

business was an attempt to combine the agility and creativity of new, small high-technology firms, often started by entrepreneurs coming out of large firms, with the access to resources at lower costs of capital available to larger companies.⁷⁵ *The Economist* asked:

Might there be a way to blend the advantage of big and small within a single firm?

The answer Mr. [George] Hatsopoulos [of Thermo Electron, then a \$200 million manufacturer of energy and environmental equipment] came up with has made Thermo a case study among American management buffs. In part this is a measure of success: since 1983, when Mr. Hatsopoulos put his strategy into practice, Thermo's compound return to shareholders has averaged 28% a year. But it has more to do with structure. Today Thermo makes everything from power plants to artificial hearts and laser hair-removers. Yet it no longer does so through one company, but through a plethora of publicly traded, stand-alone companies that it calls "spin outs". At present, 22 spin-outs-and spin-outs of spin-outs—orbit their parent, . . . including three that are not yet publicly traded.

Although Thermo keeps a majority stake in each spin-out, it gives them far more freedom than a conventional subsidiary. It hands over day-to-day control of the companies and fistfuls of share options to the staff. Unusually, Thermo's spin-outs—rather than Thermo itself—keep the proceeds when their shares are sold to the public. Thermo does, however, profit from a "gain on issuance of stock by subsidiaries"—the difference between the book value and sale price of minority stakes. This can add up: last year Thermo's gain from spin-outs chipped in one-third of its \$375 [million] pretax profit on sales of \$2.9 billion.⁷⁶

Similar to the difficulty in categorizing the structure of Idealab discussed *supra*, *The Economist* expressed difficulty in categorizing the structure of Thermo and its spin-outs:

Thermo can sound like a venture-capital group or even an investment trust. But whereas venture-capital firms often just hand over the cash and leave entrepreneurs to their fate, Thermo acts as an incubator. It supplies its spin-outs with banking, legal, taxation, human-resources, corporate-relations and other services for a flat fee of 1% of each spin-out's revenues. It also lends them its name. John Wood, president of Thermedics (which was Thermo's first spin-out in 1983), says that this makes it far easier for start-ups to attract outside investors and customers.⁷⁷

Hatsopoulos's creation of a "firm that is able to move effortlessly from niche to niche and is uniquely capable of sustained

75. *Spinning it out at Thermo Electron*, THE ECONOMIST, Apr. 12, 1997, at 57.

76. *Id.*

77. *Id.*

long-term growth" has been used as a model for firms both in the United States and abroad.⁷⁸ Ultimately, Idealab and Thermo, and their progeny, as well as more traditional innovative companies such as 3M, must ask "how to craft a coherent, long-term strategy from an unpredictable ideas machine."⁷⁹ Forming and managing a coherent, long-term strategy requires an additional, albeit different, form of intellectual capital: the relational capital required to manage people-sensitive businesses.

Regardless of the forms in which international business will be conducted, the global economy will be different from the economy in the Industrial Revolution. An example of such evolution is the Internet. Whereas today many Internet tasks may seem elementary, its potential impact on the economy cannot be underestimated. A second stage might consist of Internet commerce that functions within the current institutional framework and employs both national currencies and jurisdiction. Visa International, the credit card consortium, is testing "electronic purse" credit cards equipped with microchips to enable consumers to make electronic payments in cash over the Internet.⁸⁰ Last year, two companies announced agreements with Netscape to bundle their software to process Internet payments.⁸¹ A third, more advanced stage would mark the transition to true cybercommerce.⁸² Some commentators

78. *Id.* "Thermo has been used as a benchmark by such giants as W.R. Grace, Kmart, BP, and Westinghouse. . . . Thermo has also been mimicked by companies such as The Limited, a clothes retailer, Acer, a Taiwanese computer maker that wants to split itself into 20 different firms, and Idealab, a year-old nurturer of Internet start-ups." *Id.*

79. *Id.* at 58.

80. Nicholas Bray, *Visa to Test Cards For Possible Use On the Internet*, WALL ST. J., Feb. 10, 1997, at A5A.

81. *VeriFone, CyberCash See Stock Price Rise After Netscape Pacts*, WALL ST. J., Mar. 3, 1997, at A12.

82. JAMES DALE DAVIDSON & LORD WILLIAM REES-MOGG, *THE SOVEREIGN INDIVIDUAL* 184 (1997). The United States Department of the Treasury recently issued a paper, *Selected Tax Policy Implications of Global Electronic Commerce* (1996), (last modified Nov. 27, 1996) <<http://www.ustreas.gov/treasury/tax/internet.html>>, that considers federal income tax policy and administration issues presented by developments in communications technology and electronic commerce. Although the paper does not present the Treasury Department's legal or policy views, it was designed to solicit comments on those tax issues that relate to electronic transactions. The paper, recognizing that the Internet has effectively eliminated national borders on the information superhighway, stated that "cross-border transactions may run the risk that countries will claim inconsistent taxing jurisdictions, and that taxpayers will be subject to quixotic taxation. If these technologies are to achieve their maximum potential, rules that provide certainty and prevent double taxation are required." *Id.* According to the paper, developments in technology and electronic commerce dictate that certain parts of the Internal Revenue Code and generally accepted principles of international tax policy be reexamined. *Id.* Some issues of concern identified in the paper include, first, identifying the country or countries having jurisdic-

have envisioned the advent of a cybereconomy where business transactions exist completely outside of the jurisdiction of nation-states. One commentator has opined:

Not only will transactions occur over the [Internet], but they will migrate outside the jurisdiction of nation-states. Payment will be rendered in cyber-currency. Profits will be booked in cyberbanks. Investments will be made in cyberbrokerages. Many transactions will not be subject to taxation. At this stage, cybercommerce will begin to have significant megapolitical consequences . . . The powers of governments over traditional areas of the economy will be transformed by the new logic of the [Internet]. Extraterritorial regulatory power will collapse. Jurisdictions will devolve. The structure of firms will change, and so will the nature of work and employment.⁸³

One need not agree with those prognostications. However, what is indisputable is that advances in technology have enormous economic, political and social implications. It is inevitable that the consequences of new technology and new applications of computers and communications will continue to have an immense impact on business, with firms forming new operating structures to secure an increasingly short, competitive advantage in an ever expanding and highly competitive global marketplace.

C. *The Rise of "Ceremonial" Nationality.*

The shift from an industrial to an information society has coincided with the expansion of the global economy. Businesses no longer compete strictly in local or domestic markets. Even if a business were deliberately to decide to focus on its local community and not to export, it is increasingly likely that the business would face competition from foreign-based concerns expanding into the very markets in which that business sought to operate. For practically all persons in the developed world, local expenditures for food, clothing and shelter will continue to remain a significant portion of total expenditures. However, with the advent of the twenty-first century, the expenditures for all goods and serv-

tion to impose tax on the electronic transaction's income. *Id.* The growth of transactions in cyberspace will likely move policy away from traditional concepts of source-based taxation toward residence-based taxation. *Id.* The second is classifying income arising from digitized information (e.g. computer programs, images, books, music). *Id.* Due to the ease of transmitting and reproducing digitized information, the distinction between royalty income, service income, and a sale of goods should be refined. *Id.* The third issue deals with the possibility of anonymous or untraceable transactions. *Id.* Issues related to identifying parties to transactions and verifying records when commerce is conducted electronically are discussed. According to the paper, if similar income is produced, physical and electronic transactions should be treated equally for tax purposes. *Id.*

83. DAVIDSON & REES-MOGG, *supra* note 82, at 184-85.

ices that originate transnationally can be expected to rise proportionately to the level at which such goods and services are produced. Consumer spending is expected to expand within the next ten years, particularly in developed countries with aging populations. For example, in the United States, the proportion of consumer spending is expected to increase significantly as the first baby boomers, who have already turned fifty, will move into retirement age.⁸⁴ As much of the consumer spending increases, it is foreseeable that, as a minimum, a comparable portion will be expended on transnational goods and services. One commentator recently estimated the growth in the level of internationally traded goods and services as follows:

[T]he WTO predicted that merchandise trade would grow at a "robust level around 7 percent" in 1996. If it continues to grow at current rates, it will double in ten years to about \$10 trillion. And that is just merchandise trade; exports on commercial services could easily total \$3 or \$4 trillion 10 years from now. To put the total gain in perspective, \$13 or \$14 trillion is about half of current total global output.⁸⁵

Moreover, even though consumers will continue to make localized expenditures for goods and services in significant number, the source of those goods and services will be international. Numerous international trade disputes under the GATT system have arisen over the importation of relatively low-cost, consumer goods, including almonds,⁸⁶ apples and pears,⁸⁷ beef,⁸⁸ grapes,⁸⁹ sugar,⁹⁰ screw-

84. See Kim Clark, *First: Why You Should Worry About the Wealth Effect*, FORTUNE, Mar. 31, 1997, at 24, for an interesting discussion about why U.S. consumers have not gone on a spending spree brought on by the rising stock market.

85. Charles R. Carlisle, *Is the World Ready for Free Trade?*, FOREIGN AFFAIRS, Nov.-Dec. 1996, at 113, 126.

86. See *United States v. India*: Import Restrictions on Almonds, complaint filed June 17, 1987 (C/M/211) (involving a dispute over almonds). The GATT panel made no ruling in that dispute. However, India agreed to increase its almond import quota for three years to \$20 million, and then to abolish it upon India's attainment of certain trade balance objectives. HUDEC, *supra* note 6, at 548-49.

87. See *United States v. Norway*: Restrictions on Imports of Apples and Pears, Apr. 19, 1989, GATT B.I.S.D. (36th Supp.) at 306-31 (1990) (involving a dispute over apples and pears).

88. See *United States v. Korea*: Restrictions on Imports of Beef, May 24, 1989, GATT B.I.S.D. (36th Supp.) at 268-306 (1990) (involving a dispute over beef).

89. See *Chile v. United States*: Quality Standards for Grapes, complaint filed Apr. 22, 1988 (L/6324) (involving a dispute over grapes). The GATT panel made no ruling in that dispute. No change was made in U.S. marketing order. HUDEC, *supra* note 6, at 558.

90. See *Australia v. United States*: Import Restrictions on Sugar, June 9, 1989, GATT B.I.S.D. (36th Supp.) at 331-44 (1990) (involving a dispute over sugar).

drivers,⁹¹ ice cream⁹² and video cassettes.⁹³ Therefore, it is no longer possible for businesses effectively to insulate themselves from the increasingly global nature of competition at the advent of the twenty-first century. With large U.S.-based manufacturers expanding their overseas operations, with a short-term focus on profits and with an increasing number of short-term investors, many of whom are large institutions or individuals from overseas, what will it mean to be a "U.S. company"?⁹⁴ The recent merger between Daimler-Benz and Chrysler brings the issue of a corporation's nationality into focus. One commentator observed:

The idea of a merger between German industrial champion Daimler-Benz AG and Chrysler Corp., the quintessentially American maker of Jeeps, is stunning only in its size and scope, not because one player is based in Stuttgart and the other near Detroit. In the culture that leaders of global businesses inhabit, where shared values of open markets, hard money and standardized technology increasingly take precedence over old-fashioned nationalism, such transnational combinations are logical, and they are becoming more commonplace every day.⁹⁵

The success of the American economy is often equated with the success of American corporations. Similarly, the success of foreign corporations is equated with the success of foreign nations. The success of foreign corporations leads to increased acquisitions of assets and investment, which often engenders fear in the people of the country in which investment occurs. Although such apprehension is a relatively recent phenomenon in the United States, the fear brought on by "economic imperialism" is not a new experience in many parts of the world.

Such notions of "national" success in business are rooted in common perceptions of mercantilist traditions. The nineteenth-century economist David Ricardo first articulated the comparative advantage of trade theory in *Principles of Political Econ-*

91. See *Japan v. European Community: Antidumping Regulation on Imports of Parts and Components* ["Screwdriver Assembly" Case], Mar. 22, 1990, GATT B.I.S.D. (37th Supp.) at 132-99 (1991) (involving a dispute over screwdrivers).

92. See *Canada v. United States: Import Prohibition on Ice Cream from Canada*, complaint filed Dec. 9, 1988 (L/6444) (involving a dispute over ice cream). The GATT panel made no ruling in that dispute, and no changes were made in the U.S. quota. HUDEC, *supra* note 6, at 575.

93. See *Hong Kong v. European Community: Antidumping Duty on Video Cassettes*, complaint filed June 27, 1989 (ADP/44) (involving a dispute over video cassettes). The GATT panel made no ruling in that dispute. Hudec observes, "The [anti-dumping] order remained in effect, but the extent to which Hong Kong received satisfaction, directly or indirectly, in terms of the final order or in other ways cannot be determined." HUDEC, *supra* note 6, at 579.

94. This thesis is not addressed strictly to U.S. concerns. However, discussions will be limited to U.S. companies or U.S.-based treaties as examples.

95. Joseph B. White, *Global Mall*, WALL ST. J., May 7, 1998, at A1.

omy, published in 1817.⁹⁶ Ricardo argued that England and Portugal would each gain by trading even if Portugal produced wine and cloth at a lesser cost than England.⁹⁷ If the British cost disadvantage in cloth was less than the Portuguese, then the British should specialize in exporting cloth and importing wine.⁹⁸ Ricardo recommended that the Portuguese do the reverse.⁹⁹ He concluded that both countries would be better off economically through specialization and trade in an open market than if they engaged in protectionist policies.¹⁰⁰ The Ricardian principle of comparative advantage continues to the present day, both as the framework of one of the most well known and influential doctrines in economic theory, and in its influence upon laws and treaties that affect international business.¹⁰¹

Nonetheless, the Ricardian theory of comparative advantage was based solely on exporting and importing. FDI is not part of the classical theory of international trade. Why does a firm establish FDI rather than license foreign firms? The modern theory of FDI can be traced to Stephen Hymer's dissertation at the Massachusetts Institute of Technology in 1960.¹⁰² Hymer first identified imperfections in national and international markets for products and factors of production as the preconditions for most FDI.¹⁰³ Although the market imperfections may be naturally occurring, they most typically arise through deliberate policies of either firms or governments.¹⁰⁴ For example, businesses may seek to create or exploit competitive advantages, such as the creation of new markets for existing products. Clearly, governments are apt to create market imperfections that encourage FDI by firms. One commentator has explained:

The six original members [involved in the formation of the European Economic Community in 1957] agreed to remove internal tariffs, erect a common external tariff, and coordinate their monetary and fiscal policies. Although these goals were to be accomplished over a ten-year transition period, *it was obvious to many U.S.- and European-based multinational firms that an opportunity existed to*

96. Bruce Scott, *Creating Comparative Advantage*, in INTERNATIONAL ECONOMICS AND INTERNATIONAL ECONOMIC POLICY: A READER 78, 78 (Philip King, ed. 1990).

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. ROBERT J. CARBAUGH, INTERNATIONAL ECONOMICS 16 (3d ed. 1989).

102. EITEMAN & STONEHILL, *supra* note 26, at 467. Stephen Hymer, Ph.D. dissertation, Massachusetts Institute of Technology, 1960. Hymer's study was later published as THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT (1976).

103. EITEMAN & STONEHILL, *supra* note 26, at 467.

104. *Id.*

*participate through direct foreign investment in the growth and profit that would surely come from such a large, protected market. . . . Opportunities have also been created by governments in less developed countries that have potentially large, protected markets, such as Brazil, Indonesia, Nigeria, and India. It should be noted, however, that government policies to create protected markets can attract direct foreign investment only if the market is sufficiently large, or protected, to overcome diseconomies of scale from production units of less than optimal size.*¹⁰⁵

The laws of all nations favor or discriminate against foreign business interests in some way. Even in the United States, where there are few inbound restrictions for FDI and no national approval process for establishing a business, statutes restrict FDI in a number of areas.¹⁰⁶ National defense, ownership of airlines, communication companies, and high-technology fields are examples of restricted venues.¹⁰⁷

Therefore, FDI does not occur haphazardly. Rather, it is the result of conscious design by business people or governments, and it is conducted in anticipation of future profits. Although a number of other factors must be considered that have a direct impact on costs and revenues, and hence profits, ultimately FDI will flow from regions of low anticipated profit to high anticipated profit, after allowing for risk.

International law does not provide a single, agreed answer to the problem of corporate nationality, an absence that is surprising in light of the pervasiveness of corporations in the global economy. Instead, three principal criteria are recognized for determining the nationality of a corporation: the place of incorporation, the location of its seat (*siege social*) and the criterion of control. The first two criteria are traditional tests under international law; the third is relatively new.

The test of incorporation, the state according to the laws of which a corporation was formed, has been applied by states that follow the Anglo-American system of laws. The test of incorporation, along with that of the seat, was adopted by the International Court of Justice ("ICJ") in the *Barcelona Traction, Light and Power Co., Ltd.* case.¹⁰⁸ In that case, the ICJ dismissed a petition by Belgium, which espoused the claim of Barcelona Traction, because the place of the company's incorporation was in Canada.¹⁰⁹ The seat test, the state where the center of a corporation's man-

105. *Id.* at 467-68 (emphasis added).

106. See generally Edward M. Graham, GLOBAL CORPORATIONS AND NATIONAL GOVERNMENTS 92-96 (1996) (providing a brief overview of laws and regulations restricting FDI into the U.S.).

107. *Id.* at 49, 92-95.

108. *Concerning Barcelona Traction, Light and Power Co., Ltd.* (Belg. v. Spain), 1970 I.C.J. 3, 43 (Feb. 5).

109. *Id.*

agement is located (or in which it has a registered office), has been adopted mainly by states that follow the Continental system of law.¹¹⁰ Some commentators have proposed that the seat criterion should apply to multinational corporations, modified so that the test would be the place that serves as the decision-making center of a corporation.¹¹¹ The seat criterion, too, was adopted in the context of diplomatic protection in the *Barcelona Traction* case.¹¹² The test of control refers to the state of nationality of the controlling shareholders.¹¹³ It was first adopted in the context of wartime identification of enemy property and was later adopted in other economic spheres.¹¹⁴ Originally, share ownership was the sole basis for the test.¹¹⁵ As it has developed, the criterion now also accounts for other means of exercising control over the corporate activities, such as the nationality of the directors or the nationality of the shareholders with voting powers.¹¹⁶

International law applies as a matter of course to the relationships between states and international organizations.¹¹⁷ However, the individual *per se* is not, in general, a subject of international law.¹¹⁸ In recent decades, a debate has arisen among international lawyers about the ability of public international law to regulate contractual relations between states, as subjects of international law, and individuals.¹¹⁹ Some commentators have argued that contractual relations between sovereign states and private individuals cannot be regulated by the rules of international law, precisely because the rules were created to apply to states and international organizations.¹²⁰ A number of explanations have been offered in support of that contention. One is that the rules of international law are not sufficiently flexible and are inadequate to govern such agreements.¹²¹ Another is that international law lacks the rules necessary to regulate and govern complex economic activities between an investor and the host state.¹²² Jurists from the Third World have raised additional arguments that current international law establishes exclusive application of municipal law

110. MOSHE HIRSCH, *THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES* 82 (1993).

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. HIRSCH, *supra* note 110, at 82.

117. LOUIS HENKIN ET AL., *INTERNATIONAL LAW* 241-42 (3d ed. 1993).

118. *Id.*

119. HIRSCH, *supra* note 110, at 135.

120. *Id.*

121. *Id.*

122. *Id.* at 136.

to govern foreign investments in the territory of the host state.¹²³

In response to those arguments, a number of commentators have countered that international law is capable of regulating contracts between a sovereign state and a private investor, and that international law contains the basic rules necessary for this purpose (such as rules of international responsibility, which also apply to obligations of a state vis-a-vis foreign investors).¹²⁴ Further, the principles of international commercial arbitration recognize the freedom of parties to select governing law for an agreement, and thus do not hinder the parties from choosing international law.¹²⁵ Behind many of these arguments is the understandable desire of investors to apply the rules of international law as a shield against the power of the host state to unilaterally change domestic law to the detriment of the private investor. In the investors' opinion, application of the rules of international law, which cannot be changed by the host state, may constitute (whether alone or together with the laws of the host state) the best protection against unilateral changes of the agreement between the parties.¹²⁶ Moreover, Article 42(1) of the Convention on the Settlement of Investment Disputes instructs the tribunal to apply principles of international law (in combination with the laws of the host state) to investment disputes between a state and a private investor in the absence of agreement by the parties.¹²⁷ That "decisively tipped the scales toward the application of international law" to such relationships, even in disputes being settled outside the jurisdiction of arbitral panels.¹²⁸

However, the dramatic changes now affecting businesses will even more dramatically affect the nation-state system, which is the cornerstone of international law. No longer will the decisions of one nation-state be insulated enough from other nation-states to justify basing national decisions solely upon political reasons, while ignoring the economic impact of those decisions. Even the United States, the one nation-state superpower remaining at the close of the twentieth century, cannot stem the economic and tech-

123. M. Sornarajah, *Myth of International Contract Law*, 15 J. OF WORLD TRADE L. 187, 189, 210 (1981).

124. GEORGES R. DELAUME, *LAW AND PRACTICE OF TRANSNATIONAL CONTRACTS* 2-3 (1988); C.T. Curtis, *The Legal Security of Economic Development Agreements*, 29 HARV. INT'L L.J. 317, 343-44 (1988).

125. HIRSCH, *supra* note 110, at 136.

126. A study of treaties for the encouragement of investments that were concluded between 1975 and 1985 found that 52 percent of the treaties stipulate that an arbitration tribunal dealing with investment disputes shall apply principles of international law. JERZY MAKARCZYK, *PRINCIPLES OF A NEW INTERNATIONAL ECONOMIC ORDER* 260 (1988), *noted in* HIRSCH, *supra* note 110, at 136 n.142.

127. HIRSCH, *supra* note 110, at 136-37.

128. *Id.* at 138.

nological forces arrayed against it.¹²⁹ Therefore, the traditional tests governing corporations are becoming increasingly less useful in an economic world where economic decision-making is devolving and the corporation merely represents a network of intellectual capital and relationships. In addition, the traditional tests are becoming less useful because nation-states increasingly understand that injury to foreign investors hastens the economic decline of a nation-state's people.

Former U.S. Secretary of Labor Robert Reich summarized the essential options confronting the nation-state in the new economy. He observed:

Herein lies the new logic of economic nationalism: The skills of a nation's work force and the quality of its infrastructure are what makes it unique and uniquely attractive, in the world economy. Investments in these relatively immobile factors of worldwide production are what chiefly distinguish one nation from another; money, by contrast, moves easily around the world.

A work force that is knowledgeable and skilled at doing complex things, and which can easily transport the fruits of its labors into the global economy, will entice global money to it. The enticement can develop into a virtuous relationship: Well-trained workers and modern infrastructure attract global webs of enterprise, which invest and give workers relatively good jobs; these jobs, in turn, generate additional on-the-job training and experience, thus creating a powerful lure to other global webs. As skills increase and experience accumulates, a nation's citizens add greater and greater value to the world economy—commanding ever-higher compensation and improving their standard of living.

Without adequate skills and infrastructure, however, the relationship is likely to be the reverse—a vicious circle in which global investment can be lured only by relatively low wages and low taxes. These enticements in turn make it more difficult for the nation to finance adequate education and infrastructure in the future; the resulting jobs provide little or no on-the-job training and experience pertinent to more complex jobs in the future, and so on.¹³⁰

Reich recognizes the importance that the new economy plays for a nation's leaders:

Politicians and business leaders are quick to note the central importance of national economic strength, but not to comprehend the ba-

129. One commentator stated that central bankers and budget planners "don't orchestrate economic forces, they react to them." Peter Huber, *Cyberpower*, *FORBES*, Dec. 2, 1996, at 143. Former presidential advisor, James Carville is quoted as saying, "I used to think that if there was reincarnation I wanted to come back as the President, the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody." *Id.* at 144.

130. REICH, *supra* note 53, at 264-65.

sis of that strength.

... [I]ntelligent men and women occupying positions of leadership in American business and government have simply failed to understand the global economic changes that now engulf us. The premises upon which they base their daily decisions, and their prescriptions for the nation, date from a time when America was a relatively closed economy organized around high-volume, standard production. America's leaders are no different from most other Americans: products and purveyors of vestigial thought.¹³¹

Does the nationality of the owner of particular assets in a nation really matter? It is commonly presumed that foreign control of productive assets in the United States, for example, is less trustworthy, because decisions made by the foreign owners are likely to be in their own interest, rather than in the interest of the United States. The presumption arises from the notion that American control of a company is more apt to subsume the shareholder interest to the interests of the United States, or, at least, that an American investor is more likely to follow American law and be subject to the jurisdiction of an American court.¹³²

However, the continuous demands of global competition have forced large numbers of American multinationals to close factories in the United States and to move their operations overseas. Thus, an American company that closes its factory in the United States and moves it to another country is less of a "good corporate citizen" as far as American national interest than a Japanese or Italian business would be if it opened a factory in the United States. Again, Reich explains:

American capitalism was now organized relentlessly around profits, not patriotism. When profitability requires that production be shifted from an American factory to a foreign one, the American executive hesitates not.

In fact, the top executives of American corporations are among the loudest in the world in declaring that their job is to maximize shareholder returns, not to advance public goals.¹³³

In the past ten years, the growth of worldwide cross-border

131. *Id.* at 266-67.

132. Robert Reich asks,

Even if foreign executives hire Americans and give them good-paying jobs, can we be assured that they will continue to do so? They might suddenly withdraw their investments from the United States and leave us stranded. . . . This is a charming . . . naively vestigial thought, harking back to midcentury, when the core American corporation had tacit obligations . . . to balance the needs of the American public against the faintly audible demands of shareholders

Id. at 140.

133. *Id.*

merger and acquisitions ("M&As") has approximated the growth of FDI flows.¹³⁴ The total value of cross-border M&As (including both minority and majority cross-border investments and related joint ventures) had climbed to \$229 billion in 1995, twice the 1988 level.¹³⁵ Moreover, cross-border M&As during 1996 were estimated to have reached \$263 billion.¹³⁶ The 1996 World Investment Report explained the reason for that dramatic increase:

Mergers and acquisitions are a popular mode of investment for firms wishing to protect, consolidate and advance their global competitive positions, by selling off divisions that fall outside the scope of their core competence and acquiring strategic assets that enhance their competitiveness. For those firms, the "ownership" assets acquired from another firm, such as technical competence, established brand names, and existing supplier networks and distribution systems, can be put to immediate use towards better serving global customers, enhancing profits, expanding market share and increasing corporate competitiveness by employing international production networks more efficiently.¹³⁷

However, in addition to those general forces behind the growth of mergers and acquisitions, some M&As were focused on specific industries or countries. Many of the largest cross-border mergers have taken place in the telecommunications sector where formerly domestic companies sought to attain a global reach as national telecommunication monopolies were sold off.¹³⁸ The recently announced merger between Chrysler and Daimler-Benz shows that "[m]ore and more, national boundaries, cultural variations and accidents of geography such as the Atlantic Ocean aren't stopping business leaders who see a chance to expand their reach as trade barriers fall, communication becomes cheap and consumer tastes for everything from cola to cellular phones converge."¹³⁹ Similar forces were driving consolidation in air transport companies.¹⁴⁰ One commentator recently stated, "In an array of indus-

134. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 7.

135. *Id.* at 10.

136. Organisation for Economic Co-Operation and Development, *supra* note 4, at 21.

137. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 7.

138. Organisation for Economic Co-Operation and Development, *supra* note 4, at 21.

139. White, *supra* note 95, at A1.

140. Organisation for Economic Co-Operation and Development, *supra* note 4, at 21. One commentator recently observed:

Technology has transformed the airline industry, where alliances based largely on the ability of one airline to sell seats on flights operated by another are proliferating as an alternative to standard equity or cash mergers. While some airline alliances have disappointed, others appear to be winners, such as the six-way linkup that includes Germany's Lufthansa, UAL Corp.'s United Airlines, Air Canada, Thai International Airways and Scandinavian Airlines System. Lufthansa says this Star

tries—drugs, tires, finance, publishing, engineering—transnational companies formed by mergers or acquisitions or alliances are becoming the norm, not the exception."¹⁴¹

Although the trend has its own momentum, its pace is also being fueled by the rise of professional investment managers, the fungibility of short-term investment capital and the continuing need to attract additional investment capital through superior returns. The rapid increase in communications and technology, coupled with the vast increase in movement of financial assets across borders, has created an immense pool of both institutions and individual investors who are owners of firms in different parts of the world. No longer do Americans invest solely in American firms. In fact, American investors are constantly urged to diversify the ownership of their stock portfolio in order to both maximize return and to reduce risk. As a result, from 1980 through 1994, Americans invested a total of \$1.5 trillion of their portfolios in foreign securities.¹⁴²

Moreover, during 1996, United States investors increased their holdings of foreign stocks by \$176.4 billion, as near-record net purchases were expanded by a price appreciation of \$117.8 billion.¹⁴³ In addition, U.S. holdings of foreign bonds increased by \$42.7 billion during 1996.¹⁴⁴ United States-based pension funds currently invest about 11 percent of their total assets in non-U.S. investments.¹⁴⁵ Some investment advisors expect that proportion to increase over the next five years to 14 percent.¹⁴⁶ Conversely, foreign investors purchase the equity of American firms. Foreign investment in the United States equity markets was one of the driving forces behind the recent stock market surge in the United States. During 1996, foreign holdings of United States securities increased \$226 billion to \$1,225.5 billion.¹⁴⁷ That is in addition to the foreign holdings of U.S. Treasury securities by both private foreigners and international financial institutions, which increased by \$141 billion during 1996 to a record level of \$530.6 billion.¹⁴⁸

Alliance contributed about \$225 million in new revenue last year and helped to boost its trans-Atlantic traffic by more than 20%, or about double the overall trans-Atlantic growth rate.

White, *supra* note 95, at A1.

141. White, *supra* note 95, at A1.

142. Ted C. Fishman, *The Joys of Global Investment: Shipping Home the Fruits of Misery*, HARPER'S MAG., Feb. 1997, at 35.

143. Russell B. Scholl, *The International Investment Position of the United States in 1996*, U.S. DEPARTMENT OF COMMERCE, SURVEY OF CURRENT BUSINESS, July 1997, at 24, 26-27.

144. *Id.* at 27.

145. Suzanne McGee, *U.S. Investors Are Increasing Foreign Stakes*, WALL ST. J., Apr. 8, 1997, at C1.

146. *Id.*

147. Scholl, *supra* note 143, at 30.

148. *Id.* at 29.

Twenty-four hour electronic-trading links that have tied together New York, London, and Tokyo have transformed the meaning of a "national" stock market. The total return to American investors no longer depends upon the returns earned by American corporations. Rather, it depends upon the total returns from a broad portfolio of corporations throughout the world, and the care and ability with which those stocks are selected.

Therefore, the shift from an industrial to an information society has coincided with the expansion of the global economy. It is no longer possible for businesses to compete strictly in local or domestic markets. They increasingly face competition from foreign-based companies expanding into the very markets in which those businesses seek to operate. However, competition does not arise randomly. Rather, investment leading to competition occurs by the conscious design of business people or governments, in anticipation of future profits, as FDI flows from regions of low anticipated profit to high anticipated profit, after allowing for risk. Ultimately, the economic role of national government in the twenty-first century will be to provide the framework to enhance the skills of a nation's work force and to equip and sustain a high quality of national infrastructure to encourage capital mobility.

II. ANACHRONISTIC NOTIONS OF BUSINESS ARE LIKELY TO RENDER IRRELEVANT THE OECD'S PROTECTIONS FOR INVESTMENT UNDER THE MULTILATERAL AGREEMENT ON INVESTMENT.

One of the great economic developments in the post-World War II world has been the increasing interdependence of the world economy through the movement of goods and services, business enterprise, capital and technology.¹⁴⁹ Approximately 20 percent of the gross world product is internationally traded, and the growth rate for international trade is twice as large as that of the world economy as a whole.¹⁵⁰ One of the major contributing factors to the increasing interdependence has been the series of GATT agreements, which reduced both tariffs and legal controls by nations on a number of nontariff trade barriers.¹⁵¹ However, international investment has not been effectively addressed in the GATT.

Worldwide direct investment in foreign countries has reached immense proportions. Data published by the United Nations Conference on Trade and Development disclose that total investment inflows in 1995 increased by 40 percent over 1994 to \$315 billion.¹⁵²

149. CARBAUGH, *supra* note 101, at 1.

150. INTERNATIONAL BUSINESS HANDBOOK 4 (V. H. (Manek) Kirpalani ed., 1990).

151. HUDEC, *supra* note 6, at 4.

152. WORLD INVESTMENT REPORT 1996, *supra* note 1, at xiv, 4 tbl.I.1.

FDI inflows doubled between 1991 and 1995.¹⁵³ FDI is one of the major forces shaping the increasing globalization of business. By 1995, the total value of FDI that 39,000 parent firms worldwide had invested in their 270,000 foreign affiliates and subsidiaries reached \$2.7 trillion dollars.¹⁵⁴ In 1995, the most important investor countries were the United States with \$96 billion, Great Britain with \$38 billion, Germany with \$35 billion and Japan with \$21 billion.¹⁵⁵ Those four countries together accounted for almost 60 percent of the world's entire FDI during 1995.¹⁵⁶ At the same time, the United States is the most important host country for foreign investment.¹⁵⁷

The OECD is in the process of drafting the MAI to provide an extensive and predictable framework for the protection of global investment. The negotiation and implementation of MAI has great significance not only for capital-exporting countries, such as the United States and other OECD members, but also for capital-importing countries. FDI is of utmost importance to the world economy because it is a principal means for organizing production internationally and delivering goods and services throughout the world.¹⁵⁸ Governments "recognise [sic] the role of FDI in development and are actively competing for it."¹⁵⁹ The *World Investment Report* argued in favor of a comprehensive multilateral framework regarding FDI:

The overarching rationale for a comprehensive multilateral investment framework is that it would create a stable, predictable and transparent enabling framework, which would facilitate the growth of investment flows and their contribution to development. In fact, the globalization of business, the increased volumes and growing importance of FDI, the extent to which FDI and trade are inextricably intertwined and the emergence of an integrated international production system require a similarly global policy framework. A global economy requires a global policy framework, including a set of rules that is consistent for trade and investment issues.

What exists now, however, is a patchwork of bilateral, regional and multilateral agreements that contains overlaps, gaps and inconsistencies. And these problems are bound to increase as the number of bilateral and regional agreements continues to proliferate. Even a complete network of BITS covering all pairs of countries (which would require some 20,000 BITS and would take many years to negotiate) would not alleviate the problem but rather exacerbate it;

153. *Id.* at 4 tbl.I.1.

154. *Id.* at xiv.

155. *Id.* annex at 233 tbl.2.

156. *Id.*

157. *Id.* at 239-43 tbl.3.

158. WORLD INVESTMENT REPORT 1996, *supra* note 1, annex at 239 tbl.3.

159. *Id.* at 129.

the differences, complexities and uncertainties for investors (be they from developed or developing countries), as well as for governments, that would be posed by such an extensive network would become more serious, and dealing with them would become more costly, including increased transaction costs to investors and higher risk premia on investments in some countries. Small and medium-sized [transnational corporations] would be particularly disadvantaged. More generally, the sensitivity of firms to cost factors, including risks, is one of the principal motivating forces behind business' demand for a multilateral framework.¹⁶⁰

Consequently, the present system of bilateral and regional investment treaties is unsatisfactory to encourage and protect FDI in light of rapid technological and economic developments. The growth of bilateral¹⁶¹ and regional investment agreements, the inclusion of FDI-related questions in the GATT 1994 agreements and the decision of the OECD to draft the MAI clearly suggest a recognition that the current framework is inadequate and a more comprehensive framework would be more suitable.¹⁶² This Part will begin with a brief review of the current regime of bilateral, regional and multilateral investment treaties, and their inadequacies in light of the new global economic realities. This Part will then consider ways in which the MAI can rectify inadequacies under current law. Finally, this Part will examine the standards for just compensation required under international law that can be incorporated into the MAI.

A. Existing Treaty Protections for Investment Are Rooted in Static Nineteenth Century Static Economic Notions.

From its earliest history, the United States has relied upon treaties with other states to protect its commercial relations.¹⁶³ Dramatic changes have occurred in the pace, scope and structures of business, but the nature of protections offered to investors, particularly in investor-state dispute mechanisms, has failed to keep up with the transformation of business. An examination of the

160. *Id.* at 166 (citation omitted).

161. The WORLD INVESTMENT REPORT 1996 notes:

The network of BITs is expanding constantly. Some two-thirds of the nearly 1,160 treaties concluded up to June 1996 were concluded in the 1990s (172 in 1995 alone), involving 158 countries. Originally concluded between developed and developing countries, more and more BITs are between developed countries and economies in transition, between developing countries and between developing countries and transition economies.

Id. at 147 (footnote and table references omitted).

162. *Id.* at 129.

163. The first treaty, known as the Treaty of Amity and Commerce, was with France in 1778. It was negotiated by Benjamin Franklin, Arthur Lee and Silas Dean. KENNETH J. VANDEVELDE, UNITED STATES INVESTMENT TREATIES 14 (1992).

principles of customary international law through which the United States has addressed unlawful states, therefore, is helpful in considering the dispute resolution needs of the MAI.

1. *Treaties of Friendship, Commerce and Navigation.*

The earliest forms of commercial treaties entered into by the United States were treaties of Friendship, Commerce and Navigation ("FCN"). The earliest treaties focused on shipping and trading rights, but also provided some general obligations to protect the property of nationals of the other state-party.¹⁶⁴ Since the 1960s, the United States has pursued bilateral investment treaties, but many FCNs remain in force.¹⁶⁵

In the earliest FCNs, typical provisions prohibited the seizures of "'vessels, cargoes, merchandies [sic] and effects' of the other state party's nationals without payment of 'equitable and sufficient compensation' or 'sufficient indemnification.'"¹⁶⁶ That protection was later extended to all types of property.¹⁶⁷ Post-World War II FCNs provide more protections for foreign investment. Specifically, later FCNs provide business entities of each state party both most-favored-nation ("MFN") treatment and national treatment protection in a broad range of commercial and noncommercial activities.¹⁶⁸ Later FCNs also guarantee prompt, adequate and effective compensation for expropriation of property belonging to nationals or companies of the other state party.¹⁶⁹ The United States had long argued that this compensation standard was part of customary international law.¹⁷⁰ Additionally, FCNs limit (but do not prohibit) the ability of each party to impose re-

164. Some of the earliest FCNs were treaties of "amity and commerce." The term "FCN" is a generic one that refers to all bilateral commercial treaties negotiated by the United States prior to the initiation of its bilateral investment treaty program. See *id.* for a detailed discussion of the history and evolution of the United States FCN program.

165. Today, FCNs remain in force with Argentina, Austria, Belgium, Bolivia, Brunei, Columbia, Costa Rica, Denmark, Estonia, Ethiopia, Finland, France, Germany, Greece, Honduras, India, Iran, Iraq, Ireland, Israel, Italy, Japan, Korea, Latvia, Liberia, Luxembourg, Madagascar, Malta, Morocco, Nepal, the Netherlands, Norway, Oman, Pakistan, Paraguay, Saudi Arabia, Spain, Suriname, Switzerland, Taiwan, Thailand, Togo, Turkey, the United Kingdom, Vietnam, Yemen, and Yugoslavia. *Friendship, Commerce, and Navigation and Similar Treaties or Other International Agreements in Force In Whole or In Major Part*, July 27, 1853, 20 I.L.M. 565 (1981) (the State Department compilation of FCNs predates the termination of the FCN with Nicaragua). See also UNITED STATES DEPARTMENT OF STATE, *TREATIES IN FORCE* (1997) (listing current FCNs).

166. VANDEVELDE, *supra* note 163, at 16.

167. *Id.*

168. *Id.* at 16-17.

169. *Id.* at 19.

170. *Id.*

strictions on the conversion of currency.¹⁷¹

Modern FCNs also include a legal remedy for breaches of the treaties whereby any dispute between the parties relating to application of an FCN, if not settled through diplomacy, is to be submitted to the International Court of Justice ("ICJ").¹⁷² However, recourse to the ICJ provides delusive protections to investors. As one commentator observed:

FCNs do not provide a means for the resolution of investor-state disputes; they provide only for the resolution of disputes between states before the ICJ. This fact is particularly significant because the FCN remains the primary legally binding instrument governing foreign investment between the United States and other OECD nations.¹⁷³

Therefore, from its earliest history, the United States has sought to provide protection for American commerce. This protection, later extended to all types of property and for foreign investment, also guaranteed prompt, adequate and effective compensation for the expropriation of property of nationals and companies of the other state party. However, because the great increase in foreign investment by U.S. companies after World War II has created a greater likelihood of investor-state disputes, and because FCNs require a state party to undertake diplomatic protection for its private investors, FCNs ultimately have proven to be inadequate mechanisms for protecting private investors against state action.

2. *Bilateral Investment Treaties.*

Bilateral Investment Treaties ("BITs") grew in response to increased demands by United States business interests for a treaty program to protect investment.¹⁷⁴ Growth of the United States BITs program was stimulated in part by the aggressive expansion of the European network of BITs.¹⁷⁵ Between 1962 and 1972, for example, the Federal Republic of Germany entered into forty-six BITs, whereas the United States concluded only two FCNs (one with Togo and the other with Thailand).¹⁷⁶ In addition, United States businesses increasingly saw themselves as potential victims of expropriation by foreign states.¹⁷⁷ In fact, one commentator reported eighty-seven instances of expropriation during a two-year

171. *Id.*

172. VANDELDE, *supra* note 163, at 9.

173. Christopher N. Camponovo, Comment, *Dispute Settlement and the OECD Multilateral Agreement on Investment*, 1 UCLA J. INT'L L. AND FOREIGN AFF. 181, 188 (1996).

174. VANDELDE, *supra* note 163, at 20.

175. *Id.*

176. *Id.* at 19-20.

177. *Id.*

period in the 1970s.¹⁷⁸

An example of such a bilateral investment treaty is the United States-Egypt Treaty (the "Egypt BIT").¹⁷⁹ This Section will consider the scope and remedies of investment protection contained in the Egypt BIT.

a. Investment Under the Egypt BIT.

Article I(c) of the Egypt BIT defines "investment"¹⁸⁰ as "every kind of investment," and continues with a nonexclusive, illustrative list of interests that are included.¹⁸¹ Investment includes that which is owned or controlled directly or indirectly.¹⁸² To "own or control" means ownership or control that is direct or indirect, including ownership or control exercised through subsidiaries or affiliates, wherever located.¹⁸³ Therefore, in contrast to the ICJ decision in *Concerning Barcelona Traction, Light and Power Co., Ltd.*,¹⁸⁴ where the court found that a company incorporated in Canada but owned by Belgian shareholders was not entitled to the diplomatic protection of Belgium, an investment owned or controlled by United States nationals is covered, regardless of whether ownership or control is maintained through corporate tiers established under the laws of another state.¹⁸⁵ Thus, the Egypt BIT protects investments by U.S. nationals or companies no

178. *Id.* at 20.

179. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, Sept. 29, 1982, U.S.-Egypt, 21 I.L.M. 927.

180. Article I(c) of the Treaty provides:

"[I]nvestment" means every kind of investment, owned or controlled, including equity, debt, service and investment contracts; and includes, but is not limited to:

- (i) tangible and intangible property, including rights, such as mortgages, liens and pledges;
- (ii) a company or shares of stock in a company or interests in the assets thereof;
- (iii) a claim to money or a claim to performance having economic value under an investment agreement;
- (iv) valid intellectual and industrial property rights, including, but not limited to, rights with respect to copyrights, patents, trademarks, trade names, industrial designs, trade secrets and know-how, and goodwill;
- (v) licenses and permits issued pursuant to law, including those issued for manufacture and sale of products;
- (vi) any right conferred by law or contract including, but not limited to, rights, within the confines of law, to search for or utilize natural resources, and rights to manufacture, use and sell products;
- (vii) returns which are reinvested.

Id. at 929.

181. *Id.*

182. *Id.* at art. I(c), (d).

183. *Id.* at art. I(d).

184. (Belg. v. Spain), 1970 I.C.J. 3 (Feb. 5).

185. VANDEVELDE, *supra* note 163, at 45-46.

matter how many different corporate entities exist between the national or company and the investment, so long as the national or company owns or controls the investment.¹⁸⁶

Article 1(c) states that "investment" includes equity, debt, service and investment contracts, and it provides that investment includes, but is not limited to, a nonexhaustive, illustrative list of seven categories of interests that constitute investments.¹⁸⁷ The first category of investment encompasses "tangible and intangible property, including rights, such as mortgages, liens and pledges"¹⁸⁸ The second category includes "a company or shares of stock in a company or interests in the assets thereof."¹⁸⁹ As such, local subsidiaries are investments covered by the Egypt BIT.¹⁹⁰ Moreover, the local company need not be fully owned by the investor, for any ownership or other interest is treated as investment.¹⁹¹ The third category of investment is "a claim to money or a claim to performance having economic value under an investment agreement."¹⁹² (That category "is intended to exclude claims associated with a current commercial transaction, such as the sale of goods."¹⁹³) The fourth category of investment covers "valid intellectual and industrial property rights, including, but not limited to, rights with respect to copyrights, patents, trademarks, trade names, industrial designs, trade secrets and know-how, and goodwill."¹⁹⁴ The fifth category of investment is "licenses and permits issued pursuant to law, including those issued for [the] manufacture and sale of products."¹⁹⁵ The sixth category of investment is "any right conferred by law or contract including, but not limited to, rights, within the confines of law, to search for or utilize natural resources, and rights to manufacture, use and sell products."¹⁹⁶ The sixth category of investment may be broader than the fifth category because any right conferred by law or contract is entitled to protection under the terms of the Egypt BIT. The final category of investment is returns that are reinvested,¹⁹⁷ a return being "an amount derived from an investment, including

186. *Id.* at 46.

187. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. I(c), 21 I.L.M. at 929.

188. *Id.* at (i).

189. *Id.* at (ii).

190. VANDEVELDE, *supra* note 163, at 46.

191. *Id.*

192. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. I(c)(iii), 21 I.L.M. at 929.

193. VANDEVELDE, *supra* note 163, at 46.

194. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. I(c)(iv), 21 I.L.M. at 929.

195. *Id.* at (v).

196. *Id.* at (vi).

197. *Id.* at (vii).

but not limited to, profit; dividend; interest; royalty payment; management, technical assistance or other fee; and payment in kind.¹⁹⁸ The provision guarantees that reinvestment is treated as an initial investment by a national or company of the other state party.¹⁹⁹

Broad as the definitions may seem, are they broad enough to encompass current developments in business? For many, the answer is yes. Foreign investors find that Egypt has become an attractive location for conducting business.²⁰⁰ United States-based companies investing in Egypt are protected by means of the U.S.-Egypt BIT. However, the growing ranks of autonomous knowledge-based organizations, with increased investment in employee skills and supplier relationships, may still fall beyond the ambit of the Egypt BIT. Is the term "intangible property" itself broad enough to embrace future developments in business? Intangible property "includ[es] rights, such as mortgages, liens, and pledges."²⁰¹ But the "rights" are more suited to an economic world in which a parent company acquired the outstanding bonds or other debt of an affiliated company. Such rights would fast become anachronisms in a new world where horizontal networks build flexible organizations that link together traditional functions through interfunctional teams to form strategic relationships with customers and suppliers.

b. Investor-State Dispute Settlement Mechanisms Under the Egypt BIT.

The United States BITs represented a major shift in foreign

198. *Id.* at art. I(f), 21 I.L.M. at 930.

199. VANDEVELDE, *supra* note 163, at 47.

200. As one commentator remarked:

[In the recent past,] Egypt was no place to do business.

... [But,] "Egypt ... has changed".

... Just a few years ago, [Egypt] had negligible foreign reserves, a huge budget deficit and no willing lenders. Today, foreign reserves exceed \$19 billion, the budget deficit is less than 1% of gross domestic product, and inflation is under control. Egypt now has an investment-grade rating from Standard and Poor's, and it recently told the International Monetary Fund that it has no need to draw on a line of credit available under an IMF agreement.

U.S. companies, from Microsoft Corp. to McDonald's Corp., have set up shop here in the past few years, and software company Oracle Corp. is opening a Cairo subsidiary in June. Three German auto makers announced they will begin assembling cars in Egypt. Tourism is booming, with more than 50,000 new rooms in Egyptian hotels being built, including a Sheraton and a Hyatt Regency along the Sinai coast.

Amy Dockser Marcus, *Egypt Quickly Turns An Investment Famine Into Times of Plenty*, WALL ST. J., Apr. 10, 1997, at A1 (quoting Owens Corning Middle East regional general manager, Kleovoulos Leondaris).

201. See *supra* note 188 and accompanying text for a discussion of intangible property as defined by the Egypt BIT.

investment policy because BITs provided investors with a remedy that did not involve the U.S. government directly in a dispute.²⁰² BITs granted an absolute right to investors to settle investment disputes with the host state through binding arbitration before the International Center for the Settlement of Investment Disputes ("ICSID").²⁰³ The ICSID Convention also arranges the enforcement of arbitral awards.²⁰⁴

Article VII(1) of the Egypt BIT specifies that the investor-state dispute provisions apply to "legal investment disputes."²⁰⁵ One commentator has identified an ambiguity in the definition of investment dispute in BITs of this type:

[One] category of investment disputes comprises those involving an alleged breach of a right "conferred" by a BIT. The term conferred should be read to mean conferred or recognized. Because of the BITs' incorporation by reference of customary international law, a violation of that law is also a violations [sic] of an applicable BIT and any resulting dispute would be an investment dispute as that term is used in the BITs. This is so, even though rights to certain treatment under customary international law exist independently of the BITs and thus, strictly speaking, are not conferred but only recognized by the BITs.²⁰⁶

The question of whether an investment dispute arises from an alleged breach of a right "conferred" by a BIT, or from a right "recognized" by customary international law, is critical as business develops. As the definition of investment expands to recognize the value of an enterprise created through the use of networks of intellectual capital, the value of those networks will increasingly become recognized as a property right under customary international law.

c. Expropriation Under the Egypt BIT.

Article III of the Egypt BIT provides that:

202. VANDEVELDE, *supra* note 163, at 163.

203. *Id.* ICSID is an international organization established by convention in which more than 110 nations are currently members. The United States is also a party to the convention. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, March 18, 1965, 17 U.S.T. 1270.

204. VANDEVELDE, *supra* note 163, at 163.

205. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. VII(1), 21 I.L.M. at 939. Legal investment dispute is defined as:

a dispute involving (i) the interpretation or application of an investment agreement between a Party and a national or company of the other Party; or (ii) an alleged breach of any right conferred or created by this Treaty with respect to an investment.

Id.

206. VANDEVELDE, *supra* note 163, at 165.

[n]o investment or any part of an investment shall be expropriated or nationalized [either directly or indirectly] unless the expropriation

(a) is done for a public purpose;

(b) is accomplished under due process of law;

(c) is not discriminatory;

(d) is accompanied by prompt and adequate compensation, freely realizable; and

(e) does not violate any specific provision on contractual stability or expropriation contained in an investment agreement between the national or company concerned and the state party making the expropriation.²⁰⁷

The Egypt BIT includes a list of possible state actions that are deemed tantamount to expropriation.²⁰⁸ The Egypt BIT also provides that an investment may be subject to expropriation or nationalization caused by "any other measure, direct or indirect" by the host state.²⁰⁹

In the event that a "direct or indirect" measure results in expropriation, the Egypt BIT provides for the national or company to receive compensation.²¹⁰ Compensation must be equivalent to the fair market value of the expropriated investment on the date of

207. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. III(1)(e) 21 I.L.M. at 935. Article III(1)(e) also provides:

Compensation shall be equivalent to the fair market value of the expropriated investment on the date of expropriation. The calculation of such compensation shall not reflect any reduction in such fair market value due to either prior public notice of announcement of the expropriatory action, or the occurrence of the events that constituted or resulted in the expropriatory action. Such compensation shall include payments for delay as may be considered appropriate under international law, and shall be freely transferable at the prevailing rate of exchange for current transactions on the date of the expropriatory action.

Id.

208. *Id.* at art. III(1), 21 I.L.M. at 934.

209. *Id.*

210. *Id.* at (2), 21 I.L.M. at 935. Article III(2) provides:

If either Party or a political or administrative subdivision thereof expropriates the investment of any company duly incorporated, constituted or otherwise duly organized in its territory, and if nationals or companies of the other Party, directly or indirectly, own, hold or have other rights with respect to the equity of such company, then the Party within whose territory the expropriation occurs *shall ensure that such nationals or companies of the other Party receive compensation in accordance with the provisions of the preceding paragraph.*

Id. (emphasis added).

expropriation.²¹¹ However, Article VII(4) provides that in any legal investment dispute, compensation shall not exceed the "value of its affected assets."²¹² The wording in the Egypt BIT demonstrates the existing ambiguity for determining compensable value of impaired or expropriated assets. Is the compensable value to be limited to the "value of the affected assets," or will compensation reflect the fair market value of the enterprise as a going concern, or will the compensation fall somewhere between the two extremes? For the Egypt BIT, by permitting compensation of expropriated assets to fall within an array of compensable asset values, none of which is inherently more consistent with customary international law than the others, creates uncertainty and leads to a hostile economic environment. That does not advance international investment. Under such a scenario, rational investors face the following alternatives: either to seek higher prices and profits in the host country to compensate them for the additional risk of uncertainty, limit the growth of investments in the particular host country, or simply transfer their investments to economically less hostile environments.

3. North American Free Trade Agreement ("NAFTA")

The substantive protections afforded to foreign investment by NAFTA²¹³ are similar to those provided under the United States BITs. NAFTA requires national or MFN treatment for foreign investment,²¹⁴ limits expropriation,²¹⁵ directs the free movement of

211. *Id.* at (1)(e).

212. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. VII(4), 21 I.L.M. at 940-41. Article VII(4) provides:

In any proceeding, judicial, arbitral or otherwise, concerning a legal investment dispute between it and a national or company of the other Party, a Party shall not assert, as a defense, counter-claim, right of set-off or otherwise, that the national or company concerned has received or will receive, pursuant to an insurance contract, indemnification or other compensation for all or part of its alleged damages from any third Party whatsoever, whether public or private, including such other Party and its political or administrative subdivisions, agencies and instrumentalities. Notwithstanding the foregoing, *a national or company of the other Party shall not be entitled to compensation for more than the value of its affected assets, taking into account all sources of compensation within the territory of the Party liable for the compensation.*

Id. (emphasis added).

213. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 289 [hereinafter NAFTA].

214. *Id.* at art. 1103, 32 I.L.M. at 639.

215. *Id.* at art. 1110, 32 I.L.M. at 641-42. Article 1110 provides in pertinent part:

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a meas-

capital,²¹⁶ and prohibits performance requirements.²¹⁷ Like the United States BITs, NAFTA provides for investor-state dispute resolution under a regime identical to that created by the United States model BIT, as exemplified by the Egypt BIT.

However, there are a number of significant differences. First, NAFTA requires the consolidation of claims with common questions of fact or law for consideration by a tribunal established under United Nations Commission on International Trade Law ("UNCITRAL") rules.²¹⁸ The requirement is a useful mechanism for avoiding repetitive litigation.²¹⁹ Second, arbitral bodies convened to hear investor-state disputes can award only monetary damages, restitution of property, or a combination of both.²²⁰ Third, if a state that loses in arbitration fails to comply with an arbitral award, the state party whose investor prevailed may request a panel under the procedures of Articles 2008 through 2019 of NAFTA to determine whether such noncompliance is either inconsistent with obligations under NAFTA, or nullifies or impairs benefits created under NAFTA.²²¹ That innovation adds an impor-

ure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a nondiscriminatory basis;
- (c) in accordance with due process of law . . . and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

3. Compensation shall be paid without delay and be fully realizable.

....

6. On payment, compensation shall be freely transferable

Id.

216. *Id.* at art. 1109, 32 I.L.M. at 641.

217. *Id.* at art. 1106, 32 I.L.M. at 640.

218. *Id.* at art. 1120, 32 I.L.M. at 643.

219. See NAFTA, *supra* note 213, at art. 1126, 32 I.L.M. at 644 (allowing for the consolidation of claims).

220. *Id.* at art. 1135, 32 I.L.M. at 646. NAFTA also limits the authority of arbitral tribunals by precluding them from awarding punitive damages. *Id.* This constraint heads off the inevitable charges of inequitable treatment that would result from the use of punitive damages.

221. *Id.* at art. 1136, 32 I.L.M. at 646. It is not entirely clear whether the provisions of Article 2019 for the authorization of countermeasures by the tribunal are applicable at this point. Article 1136 does not expressly allow the panel to authorize countermeasures. It merely provides procedures for a state party to request the establishment of a panel to determine whether noncompliance is inconsistent with NAFTA. As a consequence, the authorization mechanism for suspension of benefits under Article 2019 can only take effect after a determina-

tant weapon in the arsenal for promoting the enforceability of arbitral judgments because it links a party's compliance with a tribunal award to access of benefits under NAFTA. However, despite the innovative and substantive new protections, NAFTA actually provides limited protection for foreign investment: it is a regional agreement with only three member states.

Chapter Eleven of NAFTA governs investment.²²² Article 1139 provides a definition of "investment,"¹¹²²³ which, compared with

tion of noncompliance is made.

222. Article 1101 states that Chapter Eleven "applies to measures adopted or maintained by a Party relating to: (a) investors of another Party; (b) investments of investors of another Party in the territory of the Party; and (c) with respect to [performance requirements and environmental measures], all investments in the territory of the Party." *Id.* at art. 1101, 32 I.L.M. at 639.

223. Article 1139 of NAFTA defines investment as:

- (a) an enterprise;
- (b) an equity security of an enterprise;
- (c) a debt security of an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;
- (d) a loan to an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the loan is at least three years but does not include a loan, regardless of original maturity, to a state enterprise;
- (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
- (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);
- (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
- (h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
 - (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or
 - (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise; but investment does not mean,
- (i) claims to money that arise solely from
 - (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
 - (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
- (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h).

Id. at art. 1139, 32 I.L.M. at 647-48.

the Egypt BIT, is broad but exclusive. For example, whereas the Egypt BIT defines investment as "every kind of investment," and then provides a nonexhaustive, illustrative list of interests that are included, NAFTA's investment definition is limited to the exclusive categories included within the definition. Nonetheless, NAFTA's investment definition is broad in scope for it includes protection for the most common subsidiary or branch relationships, as well as an interpretation of investment in which an investor is entitled to share in the income or profits of an enterprise. The scope and flexibility of NAFTA allow investors to use NAFTA's dispute mechanism as new forms of business develop new organizational structures.

NAFTA provides an additional level of protection to investors by broadly defining "enterprise." Article 201 defines enterprise as "any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association."²²⁴ As a consequence, any form of business may operate within the NAFTA region and qualify for protections available under NAFTA. Such flexibility provides an additional mantle of protection because it is not only the investment itself that is protected under NAFTA, but also the entity that is making the investment.

Article 1110 of NAFTA prohibits a state party from directly or indirectly nationalizing or expropriating an investment of an investor from another state party in its territory. It further prohibits a state party from taking a measure tantamount to nationalization or expropriation of such an investment, except when such a measure is undertaken: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law; and (d) on payment of compensation in accordance with paragraphs 2 through 6 of Article 1110. NAFTA protects an investment of an investor from another state party in a similar way to the protections afforded investors under the Egypt BIT. Specifically, the Egypt BIT protects investments by U.S. nationals or companies no matter how many different corporate entities exist between the national or company and the investment, so long as the national or company "own[s] or control[s]" the investment.²²⁵ NAFTA's Article 1139 defines "investment of an investor of a Party" in a similar manner to the Egypt BIT, provided that an "investment [is] owned or controlled directly or indirectly by an investor of such Party."²²⁶

224. *Id.* at art. 201(1), 32 I.L.M. at 298.

225. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, *supra* note 179, at art. I(d), 21 I.L.M. at 929. See *supra* note 182-86 and accompanying text for a discussion of ownership and control under the Egypt BIT.

226. NAFTA, *supra* note 213, at art. 1139, 32 I.L.M. at 648.

Finally, in the case of expropriation, NAFTA requires that "[c]ompensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ('date of expropriation'), and shall not reflect any change in value occurring because the intended expropriation had become known earlier."²²⁷ Within the text of NAFTA itself, the valuation criteria are specifically identified. Possible methods of valuation to determine fair market value include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate.²²⁸ NAFTA does not define fair market value, however.

In addition, although NAFTA does define Generally Accepted Accounting Principles ("GAAP"),²²⁹ neither Section A of Chapter Eleven of NAFTA addressing investment, nor Section B of Chapter Eleven addressing dispute settlement procedures between a state party and an investor of another state party, includes the explicit application of GAAP into a determination of fair market value of an impaired or expropriated asset. GAAP currently involves a highly sophisticated degree of professional judgment.²³⁰ As discussed in section II.C.2 *infra*, GAAP in different countries is beginning to consider ways to include estimates of intellectual and relational capital within an enterprise. In fact, there is no conceptual difference in accounting theory between estimating the useful economic future life of a specialized machine for purposes of

227. *Id.* at art. 1110(2), 32 I.L.M. at 641.

228. *Id.* at 641-42.

229. NAFTA Article 201(1) defines Generally Accepted Accounting Principles as follows:

[T]he recognized consensus or substantial authoritative support in the territory of a Party with respect to the recording of revenues, expenses, costs, assets and liabilities, disclosure of information and preparation of financial statements. These standards may be broad guidelines of general application as well as detailed standards, practices and procedures.

Id. at art. 201(1), 32 I.L.M. at 298.

230. In a recent article, Justin Fox explains the application of GAAP to financial operations of a business. He writes:

One of accounting's guiding principles is that of matching revenues and expenses over time. That's why the cost of building a factory that will be churning out cars for 20 years gets expensed over those 20 years, not when the money is actually spent. But such matching requires making *all sorts of guesses and estimates about the future. These judgments—how much to set aside for potential loan losses, what rate of return to expect on a pension fund, over how many years to spread out the cost of a factory—make earnings a better reflection of the long-term economic health of a company. . . . This is why financial analysts and money managers are supposed to know how to look beyond a company's bottom line to find the true economic value in [a company's] balance sheet or cash flow statement, or, best of all, the footnotes to its financial statements.*

Justin Fox, *Learning to Play The Earnings Game (and Wall Street Will Love You)*, FORTUNE, Mar. 31, 1997, at 77, 79 (emphasis added).

spreading the cost of the machine over its useful life, and estimating the future benefit of sending an employee to complete an educational course. The failure to connect the determination of fair market valuation for compensation under GAAP to the dispute settlement provisions of Chapter Eleven is a significant shortcoming. NAFTA ineffectively anticipates all the interrelations between investment and trade on a regional basis.

4. *General Agreement on Trade in Services ("GATS")*

The World Trade Organization ("WTO") presents a situation opposite to NAFTA: it has wide membership but creates few substantive protections for foreign investment. The General Agreement on Trade in Services ("GATS"), negotiated as part of the Uruguay Round,²³¹ marks the first time that world trade in services was brought within a legal framework similar to that for the trade in goods.²³² One commentator has observed that "surely [GATS is] among the most notable achievement of the [Uruguay] Round."²³³ Despite such an accolade, GATS primarily obligates parties to provide nondiscriminatory treatment in the field of services to service suppliers of other WTO member states.²³⁴ A party to GATS may accept an obligation to provide national treatment with regard to services and service suppliers by submitting a

231. General Agreement on Trade in Services, in Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, opened for signature Apr. 15, 1994, 33 I.L.M. 1167 [hereinafter GATS]. The Uruguay Round of Trade Negotiations, under the auspices of the General Agreement on Tariffs and Trade ("GATT"), was concluded on December 15, 1993. In addition to approving GATS, its members established the WTO and approved several other agreements, two of which relate minimally to investment, the Agreement on Trade-Related Aspects of Intellectual Property, Apr. 15, 1994, 33 I.L.M. 81 (1994) [hereinafter TRIPS Agreement], and the Agreement on Trade Related Investment Measures, Apr. 15, 1994, 108 Stat. 4809. Notably, the instruments that govern the operation of the WTO fail comprehensively to address foreign investment in any other sectors of the world economy.

232. JACKSON ET AL., *supra* note 5, at 893.

233. *Id.*

234. GATS Article XVII provides:

1. In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

GATS art. XVII (footnote omitted).

schedule indicating those sectors in which it wishes to accept the obligation.²³⁵ In its schedule, a state can also specify the terms, limitations and conditions of market access for services and service suppliers of WTO member states.²³⁶ Once a state has accepted investment-related obligations under GATS, all disputes arising thereunder are settled between states by recourse to the Dispute Settlement Board of the WTO.²³⁷ Therefore, the GATS exemptions

235. *Id.*

236. GATS Article XVI(1) provides:

With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its schedule.

Id. at art. XVI(1).

Furthermore, GATS lays out several measures a state may not impose without otherwise specifying so in its schedule. GATS, Article XVI(2) provides:

In sectors where market access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its schedule, are defined as:

- (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
- (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
- (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
- (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
- (f) limitations on the participation of foreign capital in terms of maximum percentage limit of foreign shareholding or the total value of individual or aggregate foreign investment.

Id. at art. XVI(2) (footnote omitted).

237. GATS Article XXIII provides:

1. If any Member should consider that any other Member fails to carry out its obligations or specific commitments under this Agreement, it may with a view to reaching a mutually satisfactory resolution of the matter, have recourse to the Understanding on Rules and Procedures Governing the Settlement of Disputes.
2. If the DSB considers that the circumstances are serious enough to justify such action, it may authorize a Member or Members to suspend the application to any other member or Members of such obligations and specific commitments in accordance with Section 22 (Compensation and the Suspension of Concessions) of the Understanding on Rules and

allow parties wide discretion in the level of protection offered for foreign investment.²³⁸

Moreover, GATS provides little meaningful protection for foreign investment. GATS fails to create any mandatory obligations with regard to market access, requiring merely nondiscriminatory treatment in service industries. Further, even if a state accepts an obligation to provide national treatment in a particular service sector, an investor who is injured by a breach of that obligation has no recourse under GATS. GATS provides no mandatory investor-state arbitration under the WTO. In the absence of protection for service industry foreign investment and without any effective investor-state dispute resolution, investors are left to seek the diplomatic protection of their home states for any meaningful redress of their injuries. GATS fails to establish a legal framework to protect the interest of the foreign investor while respecting the sovereignty of the host state.

5. *Uruguay Round Agreement on Trade Related Aspects of Intellectual Property (TRIPS)*.

The United States has long one of the primary advocates for strong intellectual property rights in the trading community.²³⁹ That stems from a perception that U.S. inventors and creators lose large amounts of money due to careless or indifferent protection of intellectual property in other countries.²⁴⁰ Disputes are commonplace between developed and developing nations.²⁴¹ Some commentators have suggested that "[d]eveloping countries tend to have lower levels of human capital in the population at large than developed nations, and thus perhaps less capacity in relation to

Procedures Governing the Settlement of Disputes.

3. If any Member considers that any benefit it could reasonably have expected to accrue to it under a specific commitment of another member under Part III of this Agreement is being nullified or impaired as a result of the application of any measure which does not conflict with the provisions of this Agreement, it may have recourse to the Understanding on Rules and Procedures Governing the Settlement of Disputes. If the measure is determined by the DSB to have nullified or impaired such a benefit, the Member affected shall be entitled to a mutually satisfactory adjustment on the basis of paragraph 2 of Article XXI, which may include the modification or withdrawal of the measure. In the event an agreement cannot be reached between the members concerned, Section 22 (Compensation and the Suspension of Concessions) of the Understanding on Rules and Procedures Governing the Settlement of Disputes shall apply.

Id. at art. XXIII.

238. GATS Annex on Article II Exemptions.

239. JACKSON ET AL., *supra* note 5, at 849.

240. *Id.*

241. *Id.*

their size to generate commercially valuable innovations."²⁴² Consequently, the strict enforcement of intellectual property laws in developing countries "may thus facilitate profit-making by foreigners at the expense of domestic consumers."²⁴³ On the other hand, "[w]eak laws, . . . which others may view as permitting 'piracy,' reduce domestic prices and may even facilitate export sales of the 'pirated' items."²⁴⁴ Therefore, "it is not unexpected that developing countries may prefer less restrictive intellectual property regimes than developing [sic] nations, and may even to a degree desire to specialize in 'piracy.'"²⁴⁵ "[T]he Uruguay Round TRIPS Agreement created elaborate substantive and procedural obligations binding on all GATT signatories, with surprisingly little [discretion] for developing nations."²⁴⁶

Part I of TRIPS sets out the general principles for the protection of intellectual property. These include the principle of national treatment under which the nationals of other parties must be given treatment no less favorable than that accorded to a party's own nationals with regard to the protection of intellectual property.²⁴⁷ Part I also includes a most-favored-nation clause, under which any advantage a party gives to the nationals of another country must be extended immediately and unconditionally to the nationals of all other parties, even if such treatment is more favorable than that given to the party's own nationals.²⁴⁸

242. *Id.*

243. *Id.*

244. *Id.* (footnote omitted).

245. JACKSON ET AL., *supra* note 5, at 849-50.

246. *Id.* at 884.

247. TRIPS Agreement Article 3(1) provides in pertinent part that "Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property." TRIPS Agreement art. 3(1).

248. TRIPS Agreement Article 4 provides in pertinent part:

With regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members. Exempted from this obligation are any advantage, favour, privilege or immunity accorded by a Member:

(a) deriving from international agreements on judicial assistance and law enforcement of a general nature and not particularly confined to the protection of intellectual property;

(b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;

(c) in respect of the rights of performers, producers of phonograms and broadcasting organizations not provided under this Agreement;

(d) deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the Agreement Establishing the MTO, provided that such agreements are notified to the Council for Trade-Related As-

Part II addresses each intellectual property right in succession. These include: (1) computer programs and compilations of data;²⁴⁹ (2) sound recordings, protection of performers and broadcasting organizations;²⁵⁰ (3) trademarks;²⁵¹ (4) geographical indications;²⁵² (5) industrial designs;²⁵³ (6) patents;²⁵⁴ (8) topographies of integrated circuits;²⁵⁵ (9) protection of undisclosed information;²⁵⁶ and (10) control of licensing practices or conditions pertaining to intellectual property rights that restrain competition.²⁵⁷

Part III of TRIPS sets forth the obligations of parties to provide procedures and remedies under their domestic law to ensure that intellectual property rights can be effectively enforced, both by their own nationals and by foreign owners.²⁵⁸ TRIPS mandates that a party's domestic law procedures concerning the enforcement of intellectual property rights shall be fair and equitable, without being unnecessarily complicated or costly.²⁵⁹ Those procedures are to be conducted without unreasonable time limits or unwarranted delays.²⁶⁰ But TRIPS creates no new substantive rights for the international investor. Article 41(5) of TRIPS states:

It is understood that this Part [concerning enforcement of intellectual property rights] does not create any obligation to put in place a judicial system for the enforcement of intellectual property rights distinct from that for the enforcement of laws in general, nor does it affect the capacity of Members to enforce their laws in general. Nothing in this Part creates any obligation with respect to the distribution of resources as between enforcement of intellectual prop-

pects of Intellectual Property rights and do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members.

Id. at art. 4.

249. *Id.* at art. 10.

250. *Id.* at art. 14.

251. *Id.* at arts. 15-21.

252. *Id.* at arts. 22-24.

253. TRIPS Agreement arts. 25-26.

254. *Id.* at arts. 27-34.

255. *Id.* at arts. 35-38.

256. *Id.* at art. 39.

257. *Id.* at art. 40.

258. TRIPS Agreement, Article 41(1) provides:

Members shall ensure that enforcement procedures as specified in this Part are available under their national laws so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements. These procedures shall be applied in such a manner as to avoid the creation of barriers to legitimate trade and to provide for safeguards against their abuse.

Id. at art. 41(1).

259. TRIPS Agreement art. 41(2).

260. *Id.*

erty rights and the enforcement of laws in general.²⁶¹

One commentator has observed, "There is no obligation to put in place a judicial system distinct from that for the enforcement of laws in general, nor to give priority to the enforcement of intellectual property rights in the allocation of resources or staff."²⁶² Despite Professor Jackson's assertion that "the Uruguay Round TRIPS Agreement created elaborate substantive and procedural obligations binding on all GATT signatories, with surprisingly little 'wiggle room' for developing nations,"²⁶³ TRIPS provides the international investor with the same remedies under municipal law that existed before TRIPS. Moreover, by limiting the scope of protection to traditional forms of intellectual property, TRIPS (like GATS) fails to recognize the increasing importance of new forms of intellectual capital, such as structural and relational capital, that extend beyond the bounds of traditionally recognized and governmentally-sanctioned intellectual property.

B. *Investor-State Dispute Resolution Under MAI.*

Existing machinery for the settlement of disputes between a state and a foreign private investor is far from satisfactory. Too often it is uncertain and subject to frustration. It does not fulfill effectively the ideal embodied in the legal maxim *ubi jus, ibi remedium*.²⁶⁴ However, the MAI is an opportunity to improve greatly the current unhappy state of affairs. The MAI began in May 1995 with negotiations among the members of the OECD. Negotiations for the MAI were originally expected to be completed by the time of the OECD's ministerial meeting in May 1997. However, the negotiations were not completed by the original target date, and they are now scheduled to be completed by December 1998. The primary objective of the MAI was "to provide a broad framework for international investment, with high standards for the liberalization of investment regimes and the protection of investment, and with effective dispute-settlement procedures."²⁶⁵

Although the MAI is negotiated among OECD members only, it is expected that non-OECD states will be eligible to accede to the MAI.²⁶⁶ One of the immediate difficulties confronting OECD negotiators will be to make the MAI sufficiently palatable and inviting to non-OECD states to encourage their accession to the MAI.²⁶⁷ Of all the obstacles to the task, perhaps the two most difficult ones

261. *Id.* at art. 41(5).

262. JACKSON ET AL., *supra* note 5, at 891.

263. *Id.* at 884.

264. "Where there is a right, there is a remedy." BLACK'S LAW DICTIONARY 1520 (6th ed. 1990).

265. WORLD INVESTMENT REPORT 1996, *supra* note 1, at xxxi.

266. *Id.*

267. *Id.*

that MAI negotiators must overcome are, first, the reluctance of many states to accept the principle of international jurisdiction over their disputes with foreign private investors, and second, how compensation arising from the takings of property is to be assessed and paid.

The reluctance of states to accept the principle of international jurisdiction over their disputes with foreign private investors may result from the confusion that the doctrine of sovereignty has created in international legal theory.²⁶⁸ One commentator has noted:

Even when we do not believe in the absoluteness of state sovereignty we have allowed ourselves to be persuaded that the fact of their sovereignty makes it necessary to look for some specific quality, not to be found in other kinds of law, in the law to which states are subject. We have accepted a false idea of the state as a personality with a life and a will of its own, still living in a "state of nature", and we contrast this with the "political" state in which individual men have come to live. But this assumed condition of states is the very negation of law, and no ingenuity can explain how the two can exist together. It is a notion as false analytically as it admittedly is historically. The truth is that states are not persons, however convenient it may often be to personify them; they are merely *institutions*, that is to say, organizations which men establish among themselves for securing certain objects, of which the most fundamental is a system of order within which the activities of their common life can be carried on. They have no wills except the wills of the individual human beings who direct their affairs; and they exist not in a political vacuum but in continuous political relations with one another. Their subjection to law is as yet imperfect, though it is real as far as it goes; the problem of extending it is one of great practical difficulty, but it is not one of intrinsic impossibility. There are important differences between international law and the law under which individuals live in a state, but those difference do not lie in metaphysics or in any mystical qualities of the entity called state sovereignty.²⁶⁹

Nonetheless, both United States and international law recognize state sovereignty.²⁷⁰ Inherent in the law of nations is the

268. HENKIN ET AL., *supra* note 117, at 13-14 (quoting BRIERLY, *THE LAW OF NATIONS* 54-55 (1963)).

269. *Id.* at 13-14.

270. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 206 (1986) states that the capacities, rights and duties of states include the following:

- (a) sovereignty over its territory and general authority over its nationals;
- (b) status as a legal person, with capacity to own, acquire, and transfer property, to make contracts and enter into international agreements, to become a member of international organizations, and to pursue, and be subject to, legal remedies;

right of a sovereign state to nationalize or otherwise assume control of private property for the public good. In theory, the state could either take control of the property directly, through nationalization or eminent domain, or could act indirectly, through, for example, regulation of an enterprise that effectively denies the owner the right to control its property. It is well settled that a foreign investor in a host state owes the state a great deal of obedience in return for the local protection of person and property that the investor receives during its residence.²⁷¹ The general principle of international law is that when an alien of its own accord settles in a state, the alien accepts the conditions and liabilities of a national of that state.²⁷² No state is expected to relinquish its right to exercise jurisdiction over such persons within its territory.²⁷³ The rights of a foreign investor are not derived directly from international law, but instead originate from the municipal law of the state of residence.²⁷⁴ The exercise of that sovereignty is balanced against the recognized right of the owner of the property to receive compensation for loss of private rights.²⁷⁵

In the absence of a treaty framework providing for dispute resolution, international investors have three means for obtaining redress for injuries caused by the illegal acts of a foreign nation. First, the investor may submit its claim to the domestic courts or administrative tribunals of the host state.²⁷⁶ Second, the investor may also submit its claim to the domestic adjudicatory fora of its home state. The act of state doctrine may place a formidable obstacle in the path of an investor who decides to pursue that course of action in United States courts.²⁷⁷ Moreover, such an act may re-

(c) capacity to join with other states to make international law, as customary law or by international agreement.

Id.

271. ZOUHAIR A. KRONFOL, PROTECTION OF FOREIGN INVESTMENT 14 (1972)

272. *Id.*

273. *Id.*

274. *Id.*

275. One commentator has noted that "the traditional and more acceptable view is that a state is under obligation to compensate for nationalized alien property. This is well supported by numerous authorities, by case law of international tribunals, and by state practice." *Id.* at 27. *But cf.*, M. SORNARAJAH, INTERNATIONAL LAW ON FOREIGN INVESTMENT 368-73 (1994) (concluding that an investor's right to full compensation from state action based upon solely up its right to own property is supported on "unsecured foundations").

276. *See generally*, DELAUME, *supra* note 124, at 232-260 (1988) (discussing the doctrine of sovereign immunity in the United States and European countries).

277. *See Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1963) (applying the act of state doctrine to invalidate an expropriation decree). After *Sabbatino*, the United States Congress enacted the Second Hickenlooper Amendment to the U.S. Foreign Assistance Act, 77 Stat. 386 (1963), 78 Stat. 1013 (1964), as amended 22 U.S.C. § 2370(e). The Second Hickenlooper

sult in provoking the imposition of the "Calvo Doctrine" by Latin American nations, under which a government is not bound to indemnify aliens for losses sustained by them that are greater than rights and privileges available to nationals.²⁷⁸ Third, an investor may petition its home government to espouse the investor's claim, which can bring the matter before the International Court of Justice,²⁷⁹ or pursue traditional customary international law self-help remedies of retorsion, countermeasures, or suspension or termination of a treaty. Doctrines of sovereign immunity and lack of trust

Amendment prevents U.S. courts from applying the act of state doctrine to defeat a claim based on confiscation of property in violation of international law. 22 U.S.C. § 2370(e) (1994) provides:

Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or party claiming through such state) based upon (or traced through) a confiscation or other taking after January 1, 1959, by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection: Provided, That this subparagraph shall not be applicable (1) in any case in which an act of a foreign state is not contrary to international law or with respect to a claim of title or other right to property acquired pursuant to an irrevocable letter of credit of not more than 180 days duration issued in good faith prior to the time of the confiscation or other taking, or (2) in any case with respect to which the president determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court.

Id.

Thus, the act of state doctrine may still be a valid defense to actions in United States courts based on violations of international law other than those resulting in an expropriation.

278. HENKIN ET AL., *supra* note 117, at 684-85. In summary:

[T]he impact of Calvo doctrine on the legal traditions of Latin American States is reflected in the following propositions: (a) international law requires that the host State to accord national treatment to aliens; (b) national law governs the rights and privileges of aliens; (c) national courts have exclusive jurisdiction over disputes involving aliens, who may therefore not seek redress by recourse to diplomatic protection; (d) international adjudication is inadmissible for the settlement of disputes with aliens. Latin American nations have demonstrated their attachment to those principles by rejecting, with a few exceptions, the [ICSID], and by the opposition of most of them to the conclusion of bilateral investment treaties.

Id. at 685 (quoting U.N. Centre and Commission on Transnational Corporations, 1985 REPORT OF THE CENTRE ON TRANSNATIONAL CORPORATIONS ON WORK ON THE FORMULATION OF THE UNITED NATIONS CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS, E/C.10/1985/s/2, at 15-18).

279. See HENKIN ET AL., *supra* note 117, at 406-15, for an example of this tactic as used in *Concerning Barcelona Traction, Light and Power Co., Ltd.* (Belg. v. Spain), 1970 I.C.J. 3, 43 (Feb. 5), *supra* note 108.

in local judicial systems generally render that an unattractive option to most investors. International law does impose upon a host state certain obligations that it is compelled to fulfill, including a certain minimum of rights necessary for the enjoyment of life, liberty, and property, and has thus controlled the arbitrary action of the host state.²⁸⁰

Another difficulty arises from the difference in the status of the parties: one a sovereign state, the other a private person (whether an individual, corporation or other business entity). Traditionally, the difference has been reflected in the treatment of states as persons and, hence, as subjects in international law; whereas individuals, corporations and other juridical organizations of states were regarded merely as objects of international law when they were granted rights and duties of legal personality either under customary international law or an international agreement.²⁸¹ One of the most significant developments in the post-World War II era has been the extension of the concept of international legal personality beyond the state.²⁸²

The major task in the settlement of investment disputes is to maintain judicial equality for both parties. Just as the existence of an effective enforcement mechanism will encourage states to resolve disputes amicably, the availability of an effective mechanism for investor-state dispute resolution will deter states from violating obligations under the MAI. For that reason, a key to the success of MAI as a substantive legal investment regime will be a provision enabling investors to challenge states directly in binding arbitration. The negotiators of MAI should look to NAFTA as a model because it satisfies both the interests of investors, who desire accessibility, impartiality and effectiveness, and of states, which wish to avoid unnecessarily surrendering sovereignty. To those ends, the MAI provisions for investor-state dispute settlement must incorporate three features.

First, as provided under NAFTA and the United States BITs, investors whose home states are parties to the MAI must have recourse to ICSID, the ICSID Additional Facility or any other agreed international arbitral tribunal. By so doing, the MAI can quell the fears of investors concerned with the difficulties of obtaining redress for injuries in local or home courts. After all, government measures such as expropriations, nationalizations or abrogations of contracts with foreign investors greatly disturb an investor's operations and can end an investor's presence in a host country.²⁸³ A freestanding, third-party arbitral tribunal lends much desired predictability to one's investment.

280. KRONFOL, *supra* note 271, at 14-15.

281. HENKIN ET AL., *supra* note 117, at 241-42.

282. *Id.* at 242.

283. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 190.

Second, the MAI should limit any arbitral tribunal assembled for purposes of resolving an investor-state dispute to awarding money damages only.²⁸⁴ In that way the MAI will minimize host-state objections based on sovereignty. The question then becomes what standard of compensation should be used in money damage awards. Developed countries have insisted that takings of foreign property are unlawful under international law unless they meet certain requirements, most important of which is payment of full compensation. On the other hand, developing countries have maintained that property takings are subject to the exclusive jurisdiction of the host country, which also determines how compensation is to be assessed and paid.²⁸⁵ The view of developing countries grew out of their experiences with decolonization and their efforts to assert control over natural resources in their territories.²⁸⁶ The debate between various points of view has ranged from the assertion of a need for "full, adequate and effective" compensation "to numerous qualifications of varying effect, such as 'fair' or 'appropriate' compensation."²⁸⁷

The evolution of new forms of business and increasing globalization of business create an incentive for the MAI to recognize a new modality that affirms the ever-growing importance of business networks, intellectual capital and relational capital to the creation of wealth in the twenty-first century. Specifically, through explicit integration and recognition of GAAP in the determination of fair market value of an impaired or expropriated asset, the MAI would provide investors relative assurance of fair treatment by states. In addition, if host states accede to an MAI that explicitly recognizes the use of GAAP for determining the fair market value of an impaired asset, it would create an economic climate that promotes investment by specifically stating the standards for compensation to be paid. Moreover, the evolving nature of GAAP permits both investors and states to face new opportunities. The United Nations Conference on Trade and Development ("UNCTAD") recently recognized the need for progress in compensation resulting from new vehicles and methods for conducting business, observing, "Future problems [in the area of takings of property by states] are likely to relate to *compensation for new forms of property interests of investors, . . . under which a foreign affiliate operates in a host country.*"²⁸⁸

The most compelling argument against inclusion of a binding third-party dispute settlement mechanism in the MAI is the threat

284. See, e.g., NAFTA, *supra* note 213, at art. 1135, 32 I.L.M. at 646 (resolving disputes through money damages).

285. M. SORNARAJAH, *supra* note 275, at 315.

286. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 191.

287. *Id.*

288. *Id.*

that such a mechanism poses to national sovereignty. In the area of investor-state disputes, the question arises when a host state argues that its domestic law prevents it from complying with the judgment of an arbitral tribunal, especially in the event of a conflict between a declaratory or injunctive award and contrary national legislation. For example, if an arbitral tribunal grants declaratory relief after concluding that a domestic statute is inconsistent with obligations under the MAI, there may be limits on the extent to which the state can comply with such a judgment. In the United States, a subsequent treaty is considered to prevail over an earlier inconsistent federal statute, but a subsequent federal statute prevails over an earlier inconsistent treaty.²⁸⁹ Such jurisprudential principles create a potential problem for United States courts asked to enforce declaratory or injunctive relief inconsistent with a statute enacted subsequent to the MAI. However, for purposes of investor-state dispute resolution, the objection is easily overcome. The MAI could simply authorize arbitral tribunals to award money damages only.

Therefore, MAI negotiators face a formidable task in meeting the needs of international investors, principally from the developed world, while providing a sufficiently attractive environment for developing nations to accede to the MAI. International investors need an effective investor-state dispute resolution mechanism that will deter states from violating obligations under the MAI, along with compensation standards that determine how takings of property are to be assessed and paid in an economic world where the value of a business becomes increasingly disconnected from the value of its tangible assets. Those requirements must be addressed in the face of reluctance of many states to accept the principle of international jurisdiction over their disputes with foreign private investors. By uniting the principles of GAAP into the

289. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 115 (1986) states: Inconsistency Between International Law or Agreements and Domestic Law: Law of the United States

(1)(a) An act of Congress supersedes an earlier rule of international law or a provision of an international agreement as law of the United States if the purpose of the act to supersede the earlier rule or provision is clear or if the act and the earlier rule or provision cannot be fairly reconciled.

(b) That a rule of international law or a provision of an international agreement is superseded as domestic law does not relieve the United States of its international obligation or of the consequences of a violation of that obligation.

(2) A provision of a treaty of the United States that becomes effective as law of the United States supersedes as domestic law any inconsistent preexisting provision of a law or treaty of the United States.

Id. See *Missouri v. Holland*, 252 U.S. 416 (1920); *Whitney v. Robertson*, 124 U.S. 190 (1888) (resolving conflict between a treaty and a subsequent statute by giving effect to the latter of the two).

valuation process and limiting remedies to money damages only, the MAI stands the best opportunity of balancing the competing interests of both groups.

C. Adequacy of Compensation Generally Under MAI.

The crucial question under international law has always been how is the adequacy or appropriateness of compensation to investors is to be determined, and under what guiding principles? In addition, under what guiding principles can municipal law or an arbitral body decide appropriate measures of compensation? Finally, can such measures of compensation be assayed under the crucible of the practice of international law? From the point of view of the international investor, most cases brought under investment treaties result in payment of unreasonably low compensation in relation to the value of the property taken.

1. Present International Compensation Standards are Inadequate to Promote the Development of an Integrated Global Economy.

The qualities usually required for just compensation under international law are promptness, adequacy, and effectiveness.²⁹⁰ To be adequate, compensation should correspond fully to the value of the foreign investor's interests affected by the measures of the host state. Ordinarily, an alien's actual loss will correspond to the state's gain, so that by calculating the former, the latter is also determined. However, that may be insufficient in the new era because excessive regulation or nationalization will also result in an actual loss to the host state as well. In practice, compensation has seldom been adequate, that is, proportional to the full value of the nationalized assets. In most instances of nationalization, the indemnity paid has been partial.

The practice of partial compensation has found theoretical support in the writings of several jurists, although the majority of commentators condemn the practice. Ultimately, the argument is based upon economic necessity, where a full compensation would lead the nationalizing state into bankruptcy. One commentator has maintained that the financial capacity of the expropriating state limits the obligation to pay full compensation in the case of fundamental social reforms. He argues, pragmatically, that full compensation could in effect nullify the proposed reform, which justifies payment of less than full compensation:

290. One commentator has noted, "The qualities usually required for just compensation under international law are its promptness, adequacy, and effectiveness." KRONFOL, *supra* note 271, at 110. *But cf.*, M. SORNARAJAH, *supra* note 275, at 359 (concluding that the claim to full compensation reflects the norms of the capital-exporting states, and that the "area of compensation for nationalisation [sic] is acknowledged to be one of the most controversial areas of international law").

The rule is clearly established that a State is bound to respect the property of aliens. This rule is qualified, but not abolished. . . . [A] modification must be recognised [sic] in cases in which fundamental changes in the political system and economic structure of the State or far-reaching social reforms entail interference, on a large scale, with private property. In such cases, neither the principle of absolute respect for alien private property nor rigid equality with the dispossessed nationals offer a satisfactory solution of the difficulty. It is probable that, consistently with legal principles, such solution must be sought in the granting of partial compensation.²⁹¹

Some commentators have suggested that there is no place for "full" compensation; "equitable" compensation is sufficient.²⁹² One commentator, the Soviet jurist Konstantin Katzanov, explained the use of equitable compensation:

The adoption of these two juridical bases, namely (a) the social function of property which leads to the assessment of compensation having regard to the interests of the community, and not only those of the owner, and (b) the application of the *clausula rebus sic stantibus*²⁹³ or the *theorie de l'imprevision*, by virtue of which a lessening of an obligation is sometimes justified, would give us theoretical explanation of the assessment of compensation in case of nationalization. More important it would provide us with criteria of a practical nature to help guide our steps in this uncertain "danger zone" created by the abandonment of the principle of full compensation settled in advance, which takes account only of the owner's interest. These two principles would make easier a reconciliation of the ideological and social contradictions which surround the question of compensation.²⁹⁴

Katzanov then goes on to state that when making a juridical decision on a question of compensation due upon nationalization, the following four factors, which affect the amount of compensation in municipal as well as in international law, are to be considered:

a) the nature of the nationalized property. If we recognise a social function in property, clearly we must admit that neither the intrinsic value nor the importance of property is static. They vary according to a number of elements: (1) the thing owned, (2) the type of prop-

291. H. LAUTERPACHT, 1 OPPENHEIM INTERNATIONAL LAW: A TREATISE § 155, at 352 (1957).

292. KONSTANTIN KATZANOV, THE THEORY OF NATIONALIZATION 349 (1964).

293. *Clausula rebus sic stantibus* is defined as "[a] tacit condition said to attach to all contracts meaning that they cease to be obligatory as soon as the state of facts out of which they arose has changed." BLACK'S LAW DICTIONARY 250 (6th ed. 1990). That principle has been used to demand payment on a contract based upon the original expectation value when the currency in which payment was due had become worthless through either inflation or depreciation. *Id.*

294. KATZANOV, *supra* note 292, at 353.

erty and the way in which it came into being, and (3) external social conditions.

....

b) the expediency and social necessity of the nationalisation. . . . [I]t is necessary that [nationalisation] should be socially justified, ideologically based and conscientiously effected. These requirements differ in degree and it could be said that nationalisation must be either (1) possible, (2) more or less expedient, or (3) socially or absolutely indispensable. At least one of those conditions must be fulfilled before [it can] be taken into consideration in the determination of compensation.

c) [deliberations must include] the nationalising State's material capacity to meet the expenses incurred by it as a result of the nationalisation. In practice, this factor is taken for granted, and in spite of many theoretical speculations, cannot be neglected whenever a solution is being sought.

d) Finally, the way in which the property was acquired [must be considered]. If one considers methods of acquisition which are quite normal under present conditions, one can distinguish between the acquisition of an object in an independent way and solely by means of the owner's initiative and labour, and the acquisition in which values or elements belonging to the community have played a part.²⁹⁵

According to Katzarov, fixing compensation on the basis of the above criteria will to a great extent allow the desired equity to be attained. Yet partial or inadequate compensation may be violative of international law. As one commentator has stated:

I am aware of no judicial or arbitral authority whatever for the view that a State is entitled to nationalize the property of foreigners on condition of paying only partial compensation. Nor is there any authority for the view that when the Government of foreign dispossessed owners accepts less than full compensation it acknowledges the legal right of a nationalizing Government to pay only partial compensation.²⁹⁶

As discussed *supra*, it is generally accepted that by investing in a country, a foreign investor submits itself, to a reasonable extent, to the conditions and liabilities of the country.²⁹⁷ An investor's refusal of any compensation covering a minimal portion of the losses should be determined unreasonable and, therefore, unlawful.²⁹⁸ However, partial compensation covering a major part of the

295. *Id.* at 354-56.

296. Lord McNair, *The Seizure of Property and Enterprises in Indonesia*, NETHERLANDS INT'L L.R., Vol. VI 251 (July 1959).

297. KRONFOL, *supra* note 271, at 116-17.

298. *Id.*

foreign investor's loss is, under most conditions, unreasonable and, therefore, also unlawful. The MAI should affirm the principle that partial compensation of a foreign investor's loss is unreasonable and thus unlawful. Moreover, by incorporating the standard of GAAP into the determination of fair market value of compensable loss to a foreign investor, the MAI will advance both the growth and wealth creation of the global economy in the twenty-first century.

The recognition that commercial law and, in particular, the protection available under international law have not kept pace with developments in business, technology and communications is not new. Judge Koo, writing in a separate opinion in the *Barcelona Traction Company Case*, stated:

Foreign investments constitute one form of property, rights or interests, and as such are in principle entitled to the protection of international law. Since the kinds and methods of such investment are numerous and varied, and since *they are still in the process of expansion and development, it is inevitable that at the present state of their evolution new circumstances and unfamiliar features will be encountered in the protection of such rights and interests in the international field.* But in essence they all fall within the compass of the general rule of diplomatic and judicial protection of international law. What is really involved is the basic principle of protection²⁹⁹

Large multinational corporations have traditionally required dispute settlement mechanisms against state interference vis-a-vis discriminatory laws or expropriation because they were unable to move their assembly lines or factories with ease. In the new world, all information technology, intellectual capital and other many forms of capital are highly portable. They can function independent of location. The owners of a software company, other technology company or enterprise that operates as a "network" can readily relocate. The owners can download their programs into laptops and take the next airplane out of town.

In addition, the location of an enterprise is increasingly irrelevant in a world where investors can "shop" for the most suitable governments. The concept of forum shopping for the most preferential laws and court systems is hardly new, of course. Many companies have chosen to incorporate in Delaware because of its favorable (to management) laws on corporate governance. Many international maritime agreements have long selected London, England, as the forum for litigation arising out of contractual disputes because of the extensive experience of its courts in admi-

299. *Concerning Barcelona Traction, Light and Power Co., Ltd. (Belg. v. Spain)*, 1964 I.C.J. 6, 55 (July 24) (emphasis added).

ralty matters.³⁰⁰ As one commentator has observed:

By providing efficient, integrated global data connections, telecommunication companies now offer voters the ultimate shopping experience: shopping for better government.

....

In the past you had to vote with your feet. Now you can vote with your modem, too. The [Internet] supplies an instant global storefront.

... Virtual establishments on the [Internet] already offer incorporation in Belize, bank accounts in Switzerland, currency trading in Germany, brokerage accounts in New Zealand. ...

Money, the most liquid of assets, has become the hardest to regulate. Rich people have always parked their money abroad when they didn't trust the political climate at home. Today millions of ordinary investors can move their wealth between currencies and countries as fast as they can click icons on a screen.

For some this is just an opportunity to cheat on their taxes. ...

But evading tax collectors remains a sideshow.... The center of the action involves the completely legal evasion of inept central bankers. More than \$1 trillion in foreign exchange changes hands each day around the world. (By comparison, turnover of all stocks on the New York Stock Exchange for an entire year is only around \$4 trillion.) One in seven equity trades in today's world involves a foreigner as a counterparty. And even illiquid assets—real estate, for example—are increasingly being securitized and then traded on global markets.³⁰¹

Those trends are today most evident in investors' responses to a government's management of its fiscal and monetary policy. The global extension of networks of intellectual capital will tend to accelerate improvement in the value of price-competitive and economically-rational governmental services and policies throughout the world. The imposition of onerous governmental measures, such as burdensome regulations, the addition of excessively high or discriminatory taxes, the refusal to allow repatriation of funds, or unfair treatment by administrative or judicial authorities, is detrimental to an investor's interest and threatens to impair the value of the firm. In the twenty-first century, firms will refuse to pay for governmental interference in excess of market value. For when an enterprise has hundreds of competitors competing

300. See, e.g., *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 17 (1972) (upholding a forum selection clause while referring to the London forum at issue as "experienced and capable in the resolution of admiralty litigation.")

301. Huber, *supra* note 129, at 142-43.

worldwide for the same customers or clients, it can no longer pay politicians more than the government services are actually worth. If a business were to try to do so alone, its costs would be greater than those of its competition. Therefore, the absence of significant operating advantages in a given location means that a government, as a coercive organization, will ultimately prove to be less able to extract advantages for itself.

Some commentators have deduced that the logical conclusion of such developments even portend the end of the nation-state. Kenichi Ohmae, writing in *Foreign Affairs*, observed:

The nation state has become an unnatural, even dysfunctional, unit for organizing human activity and managing economic endeavor in a borderless world. It represents no genuine, shared, community of economic interests; it defines no meaningful flows of economic activity. In fact, it overlooks the true linkages and synergies that exist among often disparate populations by combining important measures of human activity at the wrong level of analysis.

....

Governments are likely to resist giving up the power to intervene in the economic realm or to relinquish their impulses for protectionism. The illusion of control is soothing. Yet hard evidence proves the contrary.... Textiles, semiconductors, autos, consumer electronics—the competitive situation in these industries did not develop according to the whims of policymakers but only in response to the deeper logic of the competitive marketplace. If U.S. market share has dwindled, it is not because government policy failed but because individual consumers decided to buy elsewhere. *If U.S. capacity has migrated to Mexico or Asia, it is only because individual managers made decisions about cost and efficiency.*³⁰²

Negotiators for the MAI should recognize that the major way in which the current developments in business can be channeled to promote the development of the global economy is to consider what will motivate investors to enter into FDI in other countries. The question of whether the MAI's legal protections will motivate investors and promote FDI is a profound one that has enormous implications for the future economic well-being of the planet.

Traditionally, classical investment theory has focused on FDI based upon the capital arbitrage theory.³⁰³ What type of structure

302. Kenichi Ohmae, *The Rise of the Region State*, FOREIGN AFFAIRS, Spring 1993, at 78, 83 (emphasis added).

303. International capital mobility results from the differential in rates of return on capital between countries. Kojo Yelapaala, *In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies*, 7 NW. J. INT'L L. & BUS. 208, 211 n.7 (1985). According to the theory, higher rates of return will cause capital to flow from a capital-rich country to a capital-scarce country until the rates of return become equal. *Id.* Consequently,

should a company use to conduct its business operations abroad? What type of entity would best enable a business to develop new markets or products? Successful investment outside of the domestic jurisdiction requires thoughtful and reflective planning.³⁰⁴

Five phases have been identified for the development of an international business. A company that seeks to expand internationally need not undergo each one of those phases; a company may choose to skip one or more phases as appropriate to its particular circumstances. Alternatively, the form used by a company to structure its foreign operations may be a factor for future planning considerations. The phases include the following: (1) exporting;³⁰⁵ (2) use of foreign sales corporations ("FSC") and related export entities;³⁰⁶ (3) licensing agreements;³⁰⁷ (4) FDI

the MNE is an exporter of international capital and, in a sense, acts simply as an arbitrager of capital in pursuing profits by shifting equity capital from countries with low rates of return to countries with high rates of return. *Id.* Thus, the resultant profits stem from the arbitrage activity. *Id.*

304. Some of the questions that the business professional must consider include: (1) How soon can one realistically project profits for the enterprise? (2) Will the earnings from the enterprise be reinvested in the enterprise, be repatriated, or reinvested in a third entity or even third country enterprise? (3) From a U.S. tax point of view, what type of income will the enterprise earn, that is, will the enterprise create active business income or passive income? (4) Is there a need for limited liability? (5) What is the geographic location of the enterprise's activities? and (6) What are the foreign country taxation aspects related to the investment in the enterprise? Those questions represent a small sample of the issues necessary to resolve before developing an international business strategy. See ARVIND V. PHATAK, *INTERNATIONAL DIMENSIONS OF MANAGEMENT* 92-113 (4th ed. 1995), for a discussion of considerations in the development of a global strategy.

305. When a business initially establishes its presence outside of the United States, its first strategy typically utilizes sale of exported goods "free on board" from a U.S. port to a foreign distributor. The foreign distributor then sells the exported goods to its customers in the foreign market. Though exporting may result in potential credit related losses, the exporting strategy generally avoids a substantial initial capital investment in the foreign country. There are five methods that exporters use to collect funds in an international trade transaction. In order of increasing credit risk to the exporter, they are as follows: (1) cash in advance; (2) letter of credit; (3) documents against payment; (4) documents against acceptance; and (5) open account. RAJ AGGARWAL & WILLIAM R. FOLKS, JR., *INTERNATIONAL DIMENSIONS OF FINANCIAL MANAGEMENT* 170-72 (1988).

306. In light of the chronic deficit in the U.S. balance of payments, Congress created Foreign Sales Corporations ("FSCs"), designed to encourage domestic exports of goods. Essentially, FSCs exempt a percentage of profits from export sales from Federal income tax. WEST'S FEDERAL TAXATION 1-25 (William H. Hoffman, Jr. et al. eds., 1995). A corporation qualifies as a FSC

if it maintains an adequate foreign presence, has foreign management, carries out some economic processes outside the United States that are related to its export income, and complies with appropriate transfer price legislation. These rules are to ensure that the FSC is a bona fide foreign corporation that earns its exempt income from economic activi-

through joint ventures;³⁰⁸ and (5) FDI through subsidiary operations.³⁰⁹

Conventionally, multinational groups that have distributed products or services through subsidiary operations in several different countries have structured their distribution operations through the establishment of local sales subsidiaries in those countries in which significant customer bases are located. The distribution operations commonly enter into "buy-sell arrangements," in which the subsidiary sales or distribution company purchases products from the parent company of the multinational group or from other manufacturing or selling companies in the group. The

ties conducted outside the United States.

EITEMAN & STONEHILL, *supra* note 26, at 655. Both international tax planning and legal advice are required to properly evaluate and select the most appropriate vehicle, particularly for small and medium-sized exporters, as the requirements for an FSC are both detailed and stringent. *Id.* at 655-56.

307. Under a license agreement, an unrelated foreign business may be permitted to use patents, trademarks, or technology in exchange for royalties paid to the licensor, the U.S. manufacturer. License agreements offer a number of advantages, such as the avoidance of substantial capital investment by the U.S. company in the overseas market, as well as shifting the burden of costs to the licensee. However, licensing agreements are complicated from a legal point of view and require careful attention, particularly if the U.S. manufacturer eventually intends to manufacture or sell its products on its own in the future in the foreign country. See CARBAUGH, *supra* note 101, at 193-94, for an interesting discussion of the economic model and analysis comparing the costs of direct foreign investment versus licensing.

308. "An international joint venture is an association between two or more firms to carry on a separate legal entity established and controlled by the participants." INTERNATIONAL BUSINESS HANDBOOK, *supra* note 150, at 42. The term is often applied to direct investment in a foreign local partner. *Id.* A joint venture provides three principal advantages. First, because the foreign local partner presumably knows the local operating environment well, the quality of market information is reliable. *Id.* at 43. Second, less direct foreign investment is necessary to achieve local market penetration. *Id.* In some cases, part of the investment can be nonmonetary, through the exchange of assets, such as machinery or intangible assets. Third, a joint ventures' products may be better received by nationalistic local customers. *Id.* Of course, the risk created by a joint venture is that partners might not be able to reach a consensus on strategic or operating decisions. *Id.* In fact, a major study shows that there is a high "divorce rate" among U.S. firms and their joint venture partners. *Id.* In a study of 1,100 U.S. firms involved in international joint ventures, 30 percent of the joint ventures studied ended in either divorce or an increase in the U.S. partner's apparent power. J. Peter Killing, *How to Make a Global Joint Venture Work*, HARV. BUS. REV., May-June 1982, 120-27.

309. A wholly owned subsidiary provides maximum flexibility in determining the parent company's influence and power over the subsidiary. A recent report based on the experiences of 1,250 publicly-traded U.S. manufacturers found that U.S. manufacturers prefer to conduct their international activities through majority-owned subsidiaries. Charles R. Taylor & Witold J. Henisz, *The Conference Board*, U.S. MANUFACTURERS IN THE GLOBAL MARKETPLACE 21 (1994).

local sales subsidiary company is then responsible for selling the goods to customers within its country. In the most common scenario, the local sales subsidiary also takes responsibility for operations of the multinational company as a whole; that is, the local subsidiary company is involved in maintenance, warranty and other post-sale services.³¹⁰ That flexibility is inherent in the multi-national enterprise ("MNE") management and control system and permits the MNE to manage its international operations in response to changes in economic, financial and governmental considerations.³¹¹ Therefore, through the MNE system, each subsidiary can shift resources from one country to another or shift profits from high-tax countries to lower-tax countries.³¹² As a result, FDI has traditionally been viewed as replacing trade.³¹³

However, since the mid-1980s the conditions for international transactions have changed, altering both the forms of FDI and the activities of enterprises, and resulting in significant effects on the connections between FDI and trade.³¹⁴ The WORLD INVESTMENT REPORT 1996 observes:

The most important changes in the international environment [since the mid-1980s] relate to the reduction of technological and policy-related barriers to the movement of goods, services, factors of production and firms and to the fact that international production is now part of the world economy.

... Progress in information and communication technologies has not only made it possible for firms to process and communicate vastly more information at reduced costs, *but to manage, day-to-day, far-flung and widely dispersed production and service networks. Moreover, advances in combining information and telecommunication technologies have increased the transportability of many information-based services, enabling them to be traded across distances without necessarily being embodied in people or goods.* ... International production is now an integral and important part of the world economy. Numerous [enterprises] have emerged and established foreign affiliates. For 15 major developed countries, the number of [MNEs] headquartered in them nearly quadrupled between 1968/1969 and 1993, from 7,000 to 27,000. ... Worldwide, there are now almost 40,000 [MNEs], with some 270,000 foreign affiliates (not counting non-equity linkages). ... Most [MNEs] emerged as a result of sequential, step-by-step processes and most foreign affiliates

310. For example, in the Conference Board study identified in note 309 *supra*, 56 percent of the U.S. manufacturers operate sales offices abroad and 48 percent own foreign subsidiaries. *Id.* at 21.

311. Yelapaala, *supra* note 303, at 219.

312. See Avramovich, *supra* note 52, for an analysis of the international tax aspects created by intercompany transfers of goods and services.

313. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 78.

314. *Id.* at 95.

*established in the process were more or less stand-alone.*³¹⁵

The application of technology and communication allows a business to capitalize on its network of tangible and intangible assets to maximize the general efficiency of its operations. It is expected that by the twenty-first century, an investor will be able to transact business practically anywhere that wired or cellular telephone is available. If a satellite is overhead, an investor will be able to speak or transmit data over borders at will. No longer will telephone numbers identify the location of the speaker by the area code; rather, universal access numbers will reach the party with whom one wishes to communicate anywhere on the planet. However, the caller will not only be able to speak or send data; in time, the caller will also be able to speak to someone else in his own language. It will no longer matter that one party does not speak the other's language or dialect. The caller's words may be in Urdu or Farsi, but the recipient will hear them roughly translated into English. Conversely, the caller will hear the recipient's conversation in the caller's native tongue. The technological innovation of instantaneous translation will have a profound effect on economic development through access to competition in more remote parts of the planet where language obstacles currently exist.³¹⁶

Greater operational efficiency, coupled with improved access to those factors of production that firms can obtain easily and widely for production, "including such non-mobile resources as unskilled, cheap labor and competitive price-quality combinations of skilled labor and human resources for research and development,"³¹⁷ provides firms with great opportunities to grow. It also leads to increased "global competitive pressures on firms, forcing them to look continuously for ways to stay competitive."³¹⁸ It is at such a propitious time in world economic history that the MAI comes into existence. For the developments will allow the MAI

315. *Id.* at 95-96 (emphasis added).

316. The recent WTO agreement on telecommunications liberalization is expected to accelerate the pace of global information and communication interchange. One commentator observed:

[The] agreement . . . promises to lower telephone rates and add new efficiencies to the global phone system that will add up to savings of more than \$1 trillion by 2010. . . . It could spur new global telecom alliances and allow some of the poorest nations to enter the information age.

....

In the long term, consumers could benefit from better services world-wide and lower charges. For example, it currently costs about 29 times more to use a phone line in highly regulated India than it does in the largely deregulated U.S.

Douglas Lavin et al., *WTO Sets New Course for Phone Firms*, WALL ST. J., Feb. 14, 1997, at A10.

317. WORLD INVESTMENT REPORT 1996, *supra* note 1, at 97.

318. *Id.*

negotiators to provide a legal framework for the protection of investment by international investors in such a way as to reinforce the stimulus to trade begun under GATT, and now institutionalized by the WTO.

2. *Evolving Nature of GAAP Provides the Best Framework to Value Networks of Intellectual Capital.*

The MNE generally views its own national economy as too small to fulfill its potential in production, sales and resource utilization.³¹⁹ Critics of the capital arbitrage theory argue that the MNE's principal motivation to engage in foreign operations is the desire to possess proprietary knowledge or intangible assets.³²⁰ The theory holds:

[T]he most successful firms in any industry possess, in some form, intangible assets to the exclusion of other[] [firms]. The nature or character of the intangible assets may take different forms. They may represent technology, knowledge of cost-minimizing productive efficiency, patented processes, registered trademarks, designs, or brand names. They may even rest on product or trade secrets known to and shared by the employees of a particular firm or skills in styling or promoting products.³²¹

The intangible assets theory assumes implicitly that all intangible assets constitute legally-protected property with universally-recognized attributes. It assumes the existence of an international legal regime and a uniform set of national rules adequately protecting the property interest in those assets, including the grant of monopoly or semimonopoly rights to owners of industrial property limited in time to the period of protection. Thus, at the international level, adequate legal protection under the MAI would require participating host countries to recognize and protect industrial property rights similar to those enjoyed in the home country. The measurement of value of these property rights occurs through the process of accounting. The accounting process inherent in determining GAAP can provide the MAI negotiators with a model for guidance to determine the appropriate level of measurement.

Accounting is a field in a considerable state of flux. Some individuals have predicted a scientific revolution occurring in accounting because of dissatisfaction with the existing paradigm.³²² In accounting theory, "the shared paradigm has been historical costing based on the concepts of realization and matching and

319. Yelapaala, *supra* note 303, at 219.

320. *Id.* at 220.

321. *Id.* (footnote omitted).

322. The nature of scientific revolutions and dissatisfaction with existing paradigms comes from the influential work by Thomas S. Kuhn. HARRY I. WOLK ET AL., ACCOUNTING THEORY 45 and n.34 (1989).

other important tenets, such as conservatism, going concern, accounting entity, and time period."³²³ Moreover, "[a]ccounting appears to be closer to an art than a science today because much free choice exists in selecting accounting methods and rigorous measurement of phenomena by accountants is presently not a part of [the] discipline."³²⁴

The treatment of assets is particularly useful for analysis because the creation of assets results from investment. Therefore, the MAI negotiators must include within its provisions a broad definition of assets because it establishes what types of economic events and transactions will be subject to protection, as well as the measurement of valuation of those assets. The accounting profession in the United States has made three formal attempts to define assets:

(1) Something represented by a debit balance that is or would be properly carried forward upon a closing of books of account according to the rules or principles of accounting (provided such debit balance is not in effect a negative balance applicable to a liability), on the basis that it represents either a property right or value acquired, or an expenditure made which has created a property or is properly applicable to the future. Thus, plant, accounts receivable, inventory, and a deferred charge are all assets in balance-sheet classification.³²⁵

(2) Economic resources of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Assets also include certain deferred charges that are not resources but that are recognized and measured in conformity with generally accepted accounting principles.³²⁶

(3) Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.³²⁷

Accounting theorists have noted that the first definition emphasized legal property, whereas the second definition had evolved to emphasize that assets are economic resources.³²⁸ As a consequence, assets were more than legal property; anything having future economic value was an asset.³²⁹ The third definition, presently in use, is a further evolution of the concept of asset as an

323. *Id.*

324. *Id.* at 46.

325. *Id.* at 300.

326. *Id.*

327. *Id.*

328. WOLK ET AL., *supra* note 322, at 300-01.

329. *Id.* Under the second definition, a lease agreement that grants the lessee the use of property, though not the ownership, would satisfy the broader definition of asset. *Id.*

economic resource. One accounting theorist has observed:

Key characteristics of an asset are its capacity to provide future economic benefits, control of the asset by the firm, and the occurrence of the transaction giving rise to control and the economic benefits. The capacity to provide economic benefits has also been called *future service potential*. It means that an asset is something that will produce positive net cash flows in the future. These cash flows may occur in one of two ways: in a direct market exchange for another asset, or through conversion in a manufacturing operation to finished goods (which are then exchanged for another asset in a market exchange).³³⁰

Thus, modern accounting theory, because of its broad concept of economic resources, permits the quantification of economic resources that will produce future benefits. That is in sharp contrast to the much narrower view contained in the first definition, in which an asset could only represent an economic resource if it could be severed from the firm and sold.³³¹ The only question then becomes how to measure the value of assets. Traditionally, accounting theory recognized the measurement of assets based upon the historical acquisition cost.³³² However, how can one begin to value assets in the twenty-first century when increasingly the value of a business reflects the firm's intellectual and relational capital? One commentator has observed, "Accountants by definition don't like things you can't measure precisely, but this is something that has to be done at an investment bank every single day. . . . I think procedures can be developed."³³³ Baruch Lev, business and law professor at the University of California at Berkeley, stated that "more and more information in financial reports is meaningless because the future of . . . companies and their industries is reflected in intangibles like [research and development], which are nowhere to be found in financial reports."³³⁴

Moreover, measuring the value of a company's human resources is increasingly recognized as important because successfully managing people businesses is more complex than managing asset-based businesses.³³⁵ Canada's Chartered Accountants have

330. *Id.* at 301.

331. *Id.*

332. Historical acquisition cost represents the exchange price of the consideration exchanged to acquire the assets and to place them in operating condition. No asset was to be recorded in excess of its cash equivalent purchase price. If the consideration was nonmonetary, then the market value of the asset received provided a more reliable basis for measuring the asset's acquisition cost. *Id.* at 303.

333. Myers, *supra* note 44, (quoting Robert Willens, accounting analyst at Lehman Brothers, Inc., a New York investment bank).

334. *Id.*

335. Richard Donkin, *There's No Accounting For Magic*, THE FIN. TIMES, Jan. 31, 1997, at 9, available in LEXIS, News Library, Curnws File. Donkin

begun to recognize that a business revolution is underway, as presented in their Inter-Institute Vision Task Force Report.³³⁶ The Vision Task Force, headed by Douglas Barrington, Chairman of Deloitte & Touche in Canada, included a distinguished panel of chartered accountants drawn from public practice, industry, government, academia and the financial community.³³⁷ The Report stated that the accountancy profession in Canada "must move beyond merely interpreting the past."³³⁸ The Report noted:

The information required to assess an organisation's performance has transcended the financial arena and now encompasses such information as: measuring environmental risk; examining the adequacy of governance and control mechanisms; addressing the effectiveness of quality management processes; assessing control over treasury operations; and benchmarking corporate strategy development. . . .

The [Chartered Accountancy] profession has been slow to address [these issues], primarily because, they and other equally important elements of organizational performance, are difficult to express in financial terms. We can no longer afford to cling to these antiquated biases.³³⁹

Task Force Chairman Barrington explained:

[M]easures that are going to be significant as predictors of future performance are moving beyond merely historical financial information. We're now looking at predictors such as the capacity of the organisation to build intellectual capital, new product introduction, the [research and development] level of expenditures and activities—indicators that measure the success of the organisation in be-

writes:

[T]he value of employees is beginning to attract increasing interest from business leaders, some of whom are showing signs of frustration at the failure of the accountancy profession to devise a satisfactory way of assessing the worth of human talent.

This is apparent in a survey of directors among 120 of the UK's top service sector companies . . .

Some two-thirds of the directors harboured [sic] frustrations, they said, because they believed that accountants placed more value on tangible assets, such as property and equipment, than on staff.

. . . .

The biggest difficulty in valuing company employees is that, unlike fixed assets, they are not owned by the business. They can and do walk out of the door.

Id.

336. Gundi Jeffrey, *The Revolution Begins*, THE ACCOUNTANT, June 1996, at 8, 8.

337. *Id.*

338. *Id.*

339. *Id.*

ing competitive.³⁴⁰

Securities and Exchange Commissioner Steven Wallman recently acknowledged the fundamental limitations arising from the use of the historical acquisition cost of assets. In a speech before the American Institute of Certified Public Accountants, Commissioner Wallman proposed:

an alternative reporting model in which financial statements and related disclosures would be viewed in different layers. . . . [T]he model focuses on providing relevant information by deemphasizing black-and-white [accounting] recognition criteria, the basis of the current core financial statements. "My goal in proposing a model is to stimulate creative thinking to address the challenges facing accounting and financial reporting in the next century," said Wallman.

"The most relevant and reliably measured items would represent the core of the financial reports. . . . Successive outer layers would consist of information that meets the requirements of recognition but . . . is not as susceptible to verification procedures."

. . . .

The first layer would include items that satisfy recognition criteria and could resemble the current core financial statements. . . . "For example, does it really make sense to recognize one parcel of real estate acquired 100 years ago in 1896 dollars in a manner identical to another piece of real estate acquired yesterday?"

The second layer would include items that satisfy recognition criteria but are not included in the core financial statement because of reliability concerns, such as research and development, advertising and similar expenditures. Other currently unrecognized elements could be included, such as the value of brands and deposit intangibles. "Establishing this additional layer of reporting outside the core allows for the reporting of relevant but perhaps less reliable information," said Wallman.

The third layer would consist of items that raise both reliability and definition concerns, such as measures of customer satisfaction. [The commissioner] said these measures contribute to earnings capacity in a tangible manner. "Customer satisfaction may sometimes meet the definition of an asset, such as when it is associated with a brand name."

A fourth layer in the reporting model could be specified for items that satisfy measurement, reliability and relevance criteria but do not meet the definitions of financial statement elements. The commissioner said that risk sensitivity metrics were a good example

340. *Id.*

of information that would fall within this layer.

Finally, a fifth layer of the model would contain relevant items that do not meet the definition of elements and cannot yet be reliably measured. Commissioner Wallman stated, "For example, the going concern value of a company, intellectual capital or the value of a trained workforce may not meet the definition of an asset because the employees to which these investments relate are not controlled by the company," said Wallman. [Therefore, he proposed that] the preparer [of the financial statements] could disclose them in the fifth layer along with a description of the limitations associated with any valuation.³⁴¹

Commissioner Wallman expected that such a new multilayered system would provide end-users with a better quality of information.³⁴² He opined, "This approach is more aligned with the purposes of financial reporting and more compatible with the dynamic nature of information that is relevant to the end-users of financial reporting."³⁴³

The problems identified by Commissioner Wallman are echoed by others in other countries. For example, at an international conference in Paris sponsored by the *Commission des Operations de Bourse*, a number of stock market regulators speculated whether the accounting profession had failed to evolve as quickly as companies had, and as a consequence, whether accounting information "no longer represented the economic realities of the 'virtual firm.'"³⁴⁴ One commentator has summarized the inherent flaws in the current system of accounting theory and the importance of ascribing value to networks of intellectual capital for business on the eve of the next century:

If management focus and company valuations continue to be based on accounting numbers, distortions will result Intellectual capital, with its ability to transform knowledge into a wealth-creating resource, is set to have a growing influence over future competitive advantage and wealth creation. But it remains largely misunderstood and under-exploited. Influenced by accounting, business education has left the overwhelming majority of man-

341. SEC Commissioner Proposes New Multilayered Reporting Model, J. OF ACCOUNTANCY, May 1996, at 14, 14-15.

342. *Id.* at 15.

343. *Id.*

344. IOSCO Examines the "Virtual Firm", WORLD ACCT. REP., Aug.-Sept. 1995, at 3, 3. "IOSCO" is the acronym for the International Organization for Securities Commissions. Its membership comprises governmental securities regulators, self-regulatory agencies, such as stock exchanges, and associations of public regulatory bodies, along with regional and international organizations involved in the regulation or development of capital markets. Angelique Kournetas, *Global Futures Markets: Towards International Cooperation and Standards in Market Regulation* (unpublished LL.M. thesis, Georgetown University) (on file with author).

agers with tools to measure and manage tangible assets, while ignoring intangible assets. Financial accounting is ideally suited to the informational needs of the machine-intensive industries they were originally intended for. Financial figures should be supplemented by assessments of intellectual capital and should be based on a broader set of measures. These in turn should extend well beyond short-term economic reports. Intellectual capital can then be protected, branded and traded like any other asset. Because of its emphasis on people, customers, structures and innovation, it provides managers with strategic antennae to peer into the future.³⁴⁵

Thus, the accounting profession is beginning to realize that measures that will be significant as predictors of future performance are moving beyond merely historical financial information. The processing and use of information is rapidly replacing the modification of physical products as the most important source of profit. Information technology divorces income-earning potential from residence in any specific geographic location. Because greater and greater portions of the value of products and services will be created by adding ideas and knowledge to a "product," an ever smaller component of added value will be subject to capture within local jurisdictions. Ideas can be formulated anywhere and transmitted globally at the speed of light. Accountants are now looking at predictors such as the capacity of the organization to build intellectual capital, new product introduction, the level of research and development expenditure, and similar activities as indicators that measure the success of the competitiveness of an organization.³⁴⁶ It is important for the MAI to move forward with the theoretical and practical developments in accountancy to measure those increasingly important aspects of business. Specifically, the MAI must acknowledge that three new forms of capital will become increasingly significant in the twenty-first century: the importance of the use of human intellectual capital; increasing importance of structural capital in organizing a business; and the importance of relational capital to the success of an enterprise. The MAI must encompass both protection to and compensation for investments that include these three new forms of capital.

The first new form of capital is the increasing importance of the use of human intellectual capital. Human capital represents a firm's collective capability to extract the best solutions from the knowledge of the persons in its network. It is critically important because it is the principal source of innovation and strategic renewal, whether it is from brainstorming in a research laboratory, daydreaming in the office, throwing out old files, re-engineering old processes, improving personal skills or developing new sales

345. Keith Bradley, *Ideas and Ideals of Intellectual Capital*, THE DAILY TELEGRAPH, Jan. 20, 1997, at 29.

346. Jeffrey, *supra* note 336, at 8.

leads.³⁴⁷

The second new form of capital recognizes the importance of structural capital in organizing a business. Structural capital is a firm's organizational capabilities for meeting market requirements. It involves the organization's routines and structures that support employees' quests for optimum intellectual performance and, therefore, overall business performance. An individual may have a high level of intellect, but if the organization has poor systems and procedures by which to track the individual's actions, the overall intellectual capital will not reach its fullest potential. An organization with strong structural capital will also have a supportive culture that allows individuals to try, fail, learn, and try again. A culture that unduly penalizes failure will have minimal success. Structuring intellectual assets with information systems can turn individual know-how into group property. A supportive culture contains elements of efficiency, transaction times, procedural innovation and access to information. It also supports elements of cost minimization and profit maximization per employee. Structural capital allows intellectual capital to be measured at an organizational level.³⁴⁸

The third new form of capital recognizes the importance of relational capital to the success of the firm. Relational capital refers to an organization's relationships or network of associates and their satisfaction with and loyalty to the company. It includes knowledge of market channels, customer and supplier relationships, industry associations and a sound understanding of the impacts of government public policy. Frustrated managers often do not recognize that they can tap into a wealth of knowledge from their own clients and suppliers. Understanding better than anyone else what customers want in a product or a service is what makes someone a business leader as opposed to a follower. Customer and supplier loyalty, target marketing, longevity of relationships and satisfaction are all measurable elements of this form of intellectual capital.³⁴⁹

The sometimes staid and tradition-bound accounting profession is beginning to recognize the transformation occurring in our world. The shift in the economic life of our planet is as dramatic as was the transformation from the Feudal Age to the Industrial Revolution. Moreover, despite the rapidity with which the changes are occurring, we are at the very first stages of the transformation. The MAI negotiators have a great opportunity to rubricate the newest and evolving forms of business, along with emerging con-

347. Nick Bontis, *There's a Price on Your Head: Managing Intellectual Capital Strategically*, U. WESTERN ONTARIO BUS. Q., Vol. 60, No. 4, June 22, 1996, at 40, available in LEXIS, News Library, Curnws File.

348. *Id.*

349. *Id.*

cepts of accounting and financial valuation, under the protection of the MAI. Such a development would be a monumental recognition that the commercial and financial interests of both investors and capital-importing host countries are converging. Nevertheless, even the recognition of such a convergence of interests by capital-importing host countries, that would lead them to MAI accession, cannot assure that private investors would invest in those host countries that need capital, investment and jobs. For even if all legal impediments to investment were removed, significant economic and infrastructure factors remain in some developing countries. However, it is foreseeable that at least some of those economic impediments will decline in coming years because of the revolution in computer and communication technology. Yet, in spite of changes in computer and communication technology, a capital-importing host-state that chooses not to accede to the MAI will ultimately have to confront, to its detriment, that its choice may have condemned it to additional decades of poverty.

CONCLUSION

The beginning of the GATT system in 1947 inaugurated a half century of unprecedented growth in global trade. International investment, however, despite its dramatic growth and magnitude, remains shackled by lesser protections than those that exist for trade. The OECD is negotiating the MAI to serve as a comprehensive global agreement for international investment to improve upon the existing crazy quilt of bilateral and regional multilateral treaties. The OECD anticipates that the MAI will provide the same level of protection for international investment that the World Trade Organization provides for international trade. The MAI is expected to begin to remove existing impediments to investments imposed by host states, in order to stimulate and protect international investment as the GATT-WTO system has done for international trade.

However, the world of international business has changed dramatically in the last fifty years. And the pace of change is accelerating; changes that in other historical periods were measured over decades, today occur in years, and sometimes even in months. The metamorphosis of this generation will prove to be as radical a change as the transition from the Feudal Age to the Industrial Revolution, not only in the economic sphere, but in society at large.

Today, the confluence of technologies, particularly in computers and communications, has facilitated worldwide communication with and management of far-flung business operations. Perhaps the most fundamental transformation is that profitability will increasingly flow not to businesses consisting of tangible assets, such as property, plant and equipment, but to networks of intellectual capital. Such networks increasingly will be used to create wealth

by applying the productivity of knowledge, intrinsic to problem solving, to providing products and services globally. As a result, in the twenty-first century knowledge will supplant large-scale, concentrated investment in property, plant and equipment as the principal strategic resource. The shift from an industrial society to an information society is a revolution.

As information becomes the strategic resource, access to the economic system becomes easier. Combined technologies of the telephone, computer and television are merging into an information and communications system that transmits data and permits almost instantaneous interaction between persons. The new integrated communications system will fuel the information society the way energy moved the industrial society and the elements sustained the agricultural society.

As a result of the change to an information society, new business structures will evolve and operate in the future, with an abundance on a global scale of smaller firms that combine the advantages of the economy of scale of large corporations with the operational flexibility and customer responsiveness typical of smaller enterprises. Some business forms and structures will be tried and abandoned; others will be found to have disadvantages; others will be disapproved by governments. Nonetheless, we can expect to see a wide range of creativity and innovation as businesses seek to create wealth in the information society.

The shift from an industrial to an information society has coincided with the expansion of the global economy. The notion of "national" firms, such as a U.S. or Japanese company, making strategic decisions from the perspective of a single country, or even a particular region of the world, is increasingly archaic. It is archaic in part because "national" firms hold no loyalty to any particular state. Moreover, virtually all larger, publicly traded companies operate in a world where significant shareholdings exist across national boundaries. Equity is held by investors, including institutions and professional money managers, from many countries with relatively short time horizons, who require a never-ending stream of ever-higher earnings. The urgency for such national businesses to produce results induces those businesses to exploit competitive opportunities wherever found.

Despite the long history of corporations operating in the international economic arena, international law does not provide a single, agreed answer to the problems of identifying, supervising, enforcing and protecting corporate nationality and its investment. The role of flourishing and prosperous national governments in the twenty-first century will be to provide the legal, economic and social framework for enhancing the skills of a nation's work force and equipping and sustaining a high quality of national infrastructure to encourage capital mobility. Therefore, the MAI has the op-

portunity to be on the cutting edge of developing international law for the protection of investments.

The current international legal framework for the protection of international investment is inadequate to protect even the existing forms of investment and enterprise. It is particularly ill-suited to protect future developments in investment and the new forms and structures of business. Moreover, it fails to provide a comprehensive framework for adequate compensation of investors for damages resulting from the impairment or expropriation of the value of investments. Even the most comprehensive treaties, such as NAFTA, with precise and fully articulated provisions and standards, fall short. On the other hand, broadly based treaties, such as the GATS and TRIPS under the auspices of the WTO, offer minimal protection and remedies beyond those currently available under municipal law.

For the MAI to make a valuable contribution to the international law for the protection of investment, the MAI negotiators must recognize that the ongoing transformation in the way international business is conducted can be channeled to promote the development of the global economy. The MAI negotiators, by considering what factors will motivate investors to enter into FDI in other countries, have a tremendous opportunity to stimulate a wave of global growth unprecedented in its scope. Indeed, the MAI must provide significant legal protections to investors to promote FDI for the future economic well-being of the planet. What is needed today is a multilateral treaty that employs flexibility and adaptability to the ever changing circumstances of the global economy. Where the MAI negotiators adopt more realistic approaches, consistent with the evolving nature of business, the investment treaty is more apt to strengthen international law, encourage its respect and foster the creation of wealth and economic opportunity throughout the world.

Thus, the MAI must encompass three provisions for the legal protection of investors and international investment. First, as to dispute settlement between the investor and the host state, the MAI must provide that investors whose home states are parties to the MAI have recourse to ICSID, ICSID Additional Facility or any other agreed international arbitral tribunal, and that any arbitral tribunal assembled for the purpose of resolving an investor-state dispute should be limited to awarding money damages only. Second, as to the adequacy of compensation, the MAI must provide international investors compensation for the full value of a foreign investor's interest affected by the measures of the host state. Third, the method of determining the full value of a foreign investor's interest must encompass the evolving nature of assets, including intangible assets, intellectual property and intellectual capital. By incorporating such protections, the MAI would facilitate the

growth of foreign direct investment leading to a new era of world prosperity at the advent of the twenty-first century.