CHAPTER VI

CONCLUDING REMARKS AND RECOMMENDATIONS

The foregoing analysis points to the need for a change of attitudes on the part of both the capital exporting as well as the capital importing countries. Their shared past seems, presently, to hang like a dead weight round their necks with the ghost of colonialism becoming ever difficult to be laid. In the formulation of international legal norms relating to private foreign investment both sides have often tended to adopt rigid postures surpassing even their own state practices. The thinking processes of the capital exporting countries and their investors continue to be conditioned by extractive calculations of a colonial era and haunted by fears of imminent take overs. The capital importing countries, on their part, are unable to shed their fears of new colonialism. No wonder then, the formulation of international legal norms relating to private foreign investment has not made much progress despite all the efforts of various UN organs and other international fora. The capital exporting and the capital importing countries continue to pit their own divergent views in all international parleys on these matters even while
making substantial compromises in their actual state practices.

The Brandt Commission has amply demonstrated that international development and the transfer of resources from the developed to the developing countries is a matter of mutual concern. It is much more so where private foreign capital is concerned which, unlike official development assistance, is a purely business proposition shorn of all considerations of charity or philanthropy. Nevertheless, a short range view of some extra gains on the part of big business in the capital exporting countries has often led to situations in which even a country like the United States of America has had to renege at the last moment after having taken all the initiatives and having actively participated in months and years of negotiations. It is necessary that both sides should appreciate the true business character of private foreign investment and approach the problem of formulating international legal norms in a purely business and economic frame of mind shorn of all prejudices

1 Havana Charter of the International Trade Organization and the more recent international Convention on the Law of the Sea are only two examples.
and political or ideological predilections. It is only then that some meaningful progress can be made in formulating universally accepted codes of rules or principles on matters that constitute the international investment climate to the mutual benefit of the capital exporting as well as the capital importing countries.

In the matter of expropriation of foreign enterprise it has been noted that general expropriation has to be distinguished from individual expropriation. In the latter case, there has been a wide acceptance in international law of the requirement of compensation. The nature and quantum of such compensation have, however, always been a matter of debate. It is only in the last few decades that the capital exporting countries have insisted on the principle of 'prompt, effective and adequate' compensation being an accepted principle of customary international law. The earlier state practices of the western countries themselves, the agreements and treaties signed among them and the writings of jurists do not bear out that claim. In that background and in the context of a large number of UN resolutions relevant to this question and the state practices of the countries under review, it has been suggested that international agreement should be sought on the principle that expropriation or nationalisation of foreign enterprise should be accompanied by 'non-
discriminatory and transferable' compensation. The word 'non-discriminatory' is meant to convey that in the matter of compensation there should be no discrimination as between a foreign investor and a national investor and the word 'transferable' would connote that, unlike in the case of a national investor, the compensation payable to a foreign investor should be paid in the currency of the country of origin. If in any particular case such payment is not immediately possible transferability may be postponed for a suitable length of time by mutual agreement on payment of at least nominal interest.

On the question of control over restrictive business practices and, in particular of devising certain binding rules of conduct for the transnational corporations, there has been considerable international activity but without much success. The transnational corporations which constitute the main vehicle for direct foreign private investment control about a third of all world production. According to the Brandt Commission, the sales of their foreign affiliates in 1976 aggregated 830 billion dollars, which was the equivalent of the then gross national product of all developing countries put together excluding
only the oil exporting countries. These transnational corporations have been often found indulging in dubious practices like transfer-pricing, over-invoicing, exchange control manipulation, pay-offs and even political subversion. The control systems designed by the capital importing countries acting singly are neither adequate, nor effective in preventing such malpractices. Even in a country like India which has elaborate legal and administrative systems, the Public Accounts Committee of Parliament have, as already mentioned, come across specific cases of abuse which have escaped such controls. In a case where as much as 70 per cent of the Indian profits were transferred untaxed under the guise of head-office expenses, the Committee found revenue officers of government totally helpless in checking the veracity of such claims. 3 It is such inefficacy


3 See, India, Lok Sabha Secretariat, Hundred and Eighty-Seventh Report of the Public Accounts Committee (Fifth Lok Sabha) (New Delhi, 1975), para 3.32; Fifty First Report of the Public Accounts Committee (Sixth Lok Sabha), (New Delhi, 1977), para 1.31.
of their controls that is forcing the capital importing countries to put physical restrictions on import of direct foreign private capital even if it means taking recourse to expensive commercial bank loans on a substantial scale. It is necessary that the efforts of the UN Commission on Transnational Corporations are reinforced and an internationally accepted Code of Conduct for the transnational corporations is designed. At the same time the fact that a binding code is not possible in the near future must be faced. In the context of the countries of South Asia it may be useful to think that while an international code even in the nature of guidelines would be welcome, it would be of advantage, in the meanwhile, to supplement local controls by some sort of a regional initiative in matters like standardization of accounting/other returns to be submitted by the transnational corporations to national authorities. This idea is given a more concrete shape in a subsequent part of this chapter.

On the question of taxation there has been more international activity than on any other. The efforts of various Committees and Groups under the League of
Nations and the UN systems have culminated in the UN Model Double Taxation Convention Between Developed and Developing Countries. The developing countries, however, take the view that this Model based on the earlier OECD Model is still weighted in favour of capital exporting countries. If, for example, the principle of taxation at source in relation to business income is accepted there is really no reason why limitations, such as those of the existence of a permanent establishment, with its definition linked to a period of time, or of the profits being directly or indirectly attributable to such permanent establishment, should be insisted upon. If the territorial nexus can be found in the source of income there are plenty of authorities for the view that 'source' does not imply any requirement as to the length of time over which a certain activity must be carried on. The conclusion is inescapable that a truly international tax convention is also yet in the womb of the future and in the meanwhile the local efforts of the countries of South Asia can well be supplemented by a regional initiative as suggested hereinafter. Independently of

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4 See, for example, Rutledge v. Commissioners of Inland Revenue, 14 TC 490, Balkowie Land Trust Limited v. Commissioners of Inland Revenue, 14 TC 684.
that, a rethinking on the question of tax-sparing provisions is immediately called for in countries like the United States of America. In an attempt to attract foreign capital, the capital importing countries are almost competing with each other in giving multifarious tax incentives. In the absence of tax sparing provisions, the benefit of these incentives is, in reality, passed on to the countries of origin and not to their foreign investors. In other words, the incentives constitute merely a transfer of resources in the reverse direction. It has been argued that a tax sparing provision violates tax equity in the country of origin in so far as the foreign investor is favoured as against a home investor. The argument is fallacious. According to the principle of compensatory state action evolved by the United States Supreme Court and applied in many other countries, equity lies not in perpetuating inequalities but in treating unequals unequally in an endeavour to make them equal. The investment in foreign countries, and particularly in under-developed countries, suffers many handicaps which do not beset investments in home countries of the foreign investors. The tax incentives are linked with still further handicaps even by the standards of the developing countries themselves. Tax
equity, therefore, does not lie in according equal
treatment to the foreign investors. It is strongly
suggested that this problem should be viewed from
that legal as well as equitable angle and the tax
sparing provisions should be universally accepted as
an essential part of all double tax treaties.

While the evolution of international legal norms
in some of the crucial areas mentioned above may continue
to be sought, the countries of South Asia, who are
faced with similar problems in analogous socio-economic
conditions and whose systems of investment laws are not
much different could derive considerable benefit from
regional initiatives. It has been demonstrated that
in matters like checking international malpractices,
such as those of transnational corporations or inter­
national tax avoidance/evasion, or formulation of tax
treaties, the efforts of individual countries are not
adequate enough. It would be useful for the countries
of South Asia to come together in setting up a regional
Centre which could:

- standardize norms such as those of account­
ing and other returns to be submitted by
transnational corporations, expenses to be
allowed to be charged off, etc
evolve concepts of incomes and expenses and allocation rules for different types of incomes and expenses

- standardise terms and phrases to be used in investment laws and meanings to be placed on them, in the long run to take initiatives in formulating regional codes such as a regional tax code

- provide expert advice on matters like designing effective management information systems and other administrative aids for evaluation of policies and incentives and for checking evasions in an attempt ultimately to design a regional convention on exchange of information on all these matters

- provide expertise for settlement of investment disputes as well as for such other matters like negotiation of bilateral tax treaties as individual countries may require.

The formulation of a regional code or even convention in this region is not being suggested straightforward as such a suggestion would imply the taking on of
a task which would not be immediately possible. What is being suggested is that initially a Centre catering to the felt needs of standardization, exchange of information and expert advice may be set up. As the Centre grows, proves its worth, and as the countries come closer in the process, initiatives towards the formulation of regional codes and/or conventions may be taken and a regional view may be presented in the formulation of international codes/conventions. On the basis of the analyses of legal and administrative systems and state practices contained in this Study it is felt that the setting up of such a Regional Centre will be of immense help in simplifying and streamlining and yet strengthening the control systems in these countries which would attract foreign capital without jeopardizing the basic policy objectives of the countries concerned.

At the local level, the greatest need in these countries is to bring about some amount of clarity and stability into their investment laws. It has been brought out elsewhere that the legal as well as administrative systems controlling investment are changed much too often and most of the time such changes are either based on ideological as distinct from economic considerations, or are just ad-hoc. Even while paying so much lip service to the need for simplifying and
rationalizing tax laws and appointing Commissions and Committees specifically for that purpose it has been demonstrated that the laws have only tended to become more and more uncertain as well as complex. A regional approach, as already suggested, can be very useful in this matter. In the meanwhile, however, the authorities in these countries must face the fact that too many ad hoc changes do not serve any purpose whatsoever; these discourage investment and create a climate for large-scale evasion without adding anything to the fulfilment of the basic policy objectives or augmenting tax revenues. They must also face the fact that all their professions for simplification and rationalisation and the special enquiries set up by them for that purpose have not produced any results so far. It is by facing this truth boldly that a really meaningful start can be made.

In relation to regulation and control of industries, the policies have been considerably liberalized in all these countries in the last few years. The extent of liberalization, of course, varies from country to country. But the attempts at selling such liberalization have not been as good as they ought to be. This is particularly so in the case of India where
a sort of political commitment to the original policies comes in the way of putting across the liberalized policies for what they are. This has often tended to create some sort of dichotomy between actual practices and the pronounced policies causing confusion in the minds of foreign investors. For example, an elaborate industrial licensing procedure has been on the statute book in India for quite some time. This remains the pronounced policy. In practice 'exemptions' have been so many and of such consequence, and evasions have been so lightly put up with or remained 'unnoticed' that the pronounced policy is a bugbear frightening only those who do not have the time or the inclination to unravel the reality underneath. The Public Accounts Committee of Parliament have had occasion to comment on cases where actual production has exceeded the licensed capacity by as much as 700 per cent and such cases have remained 'unchecked'.

Similarly, in the case of foreign investment, an elaborate set of 'guidelines' has been laid down. In practice these have neither reduced the outflow of investment incomes, nor transferred management.

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5 India, n.3, Hundred and Eighty Seventh Report, para 1.42, Fifty First Report, para 1.18.
control to Indian hands on any large scale. In either case, exemptions are made on considerations which are neither evaluated nor strictly enforced. Export promotion, for example is one of the most important considerations but control an actual fulfilment of export obligations is fairly lax. A pragmatic approach in these matters could help simplify legal controls without sacrificing any of the basic goals. The emphasis on case by case approach involved in a network of exemptions is itself very discouraging because it creates an atmosphere of fear as well as suspicion. If the basic control systems and the legal framework containing them are themselves simplified consistent with current policies and state practices, the gainers would be both administrative efficiency and foreign as well as indigenous investment. The present elaborate fabric of control systems riddled by myriad holes of 'undetected' evasions and notified exemptions could be substituted by a brief the size of a kerchief which is there for all to see.

6 See, for example, Report of the Comptroller and Auditor General of India for the year 1981-82, Union Government (Civil) Revenue Receipts, (New Delhi, 1983), vol. 1, para 1.25.
There is too much emphasis in these countries on providing tax incentives through export processing zones or otherwise. Most of these incentives are, prima-facie, linked with the fulfilment of certain socio-economic objectives. There are, however, no evaluation systems and the incentives are frequently changed without really knowing their true effect before or after each such change. In India, for example, it has been admitted in evidence before the Public Accounts Committee of Parliament, time and again, that there is no departmental system or machinery to review and evaluate the tax incentives, to understand how far they have produced the desired results, much less to evaluate whether the fulfilment of objectives has been consistent with the revenue sacrifice involved.7

The Committee's demonstration of the fact that with so many tax incentives the effective rate of tax has been

7 See, for example, India, Lok Sabha Secretariat, Forty-Fifth Report of the Public Accounts Committee (Sixth Lok Sabha), (New Delhi, 1977), paras 1.41 and 1.50, Hundred and First Report of the Public Accounts Committee (Sixth Lok Sabha), New Delhi, 1978, para 1.13.

Fifty-First Report of the Public Accounts Committee (Seventh Lok Sabha), (New Delhi, 1981), paras 1.106 and 1.131 and

constantly going down from year to year and more and more of the highly successful companies earning high rates of profits have been virtually going out of the tax net, has been met with a solution that places an overall legal ceiling on all the incentives put together of 70 per cent of profits. This is apparently a counsel of despair. The ceiling is as ad hoc as the incentives themselves. If on a proper evaluation it is found that the incentives are really serving the socio-economic objectives for which these are designed there would apparently be no point in putting a ceiling on them. If, on the other hand, it is seen on such evaluation that the incentives have not served the purpose in view there is hardly any justification for allowing them even within the prescribed ceiling. In other words, the fixation of an ad hoc ceiling like this is really no answer to the problem; what is required is the building up of appropriate monitoring and information systems which would provide data for a proper evaluation. Policy decisions taken on the basis of such evaluation and translated into laws could help fulfillment of the basic policy objectives and also bring in greater revenues.

The tasks undertaken in this study, as mentioned at the outset, were an examination of the evolution of
international legal norms and a presentation of the current laws and state practices of the countries of South Asia. Some of the ideas that have emerged in connection with the formulation of international legal norms are stated in the concluding remarks in various chapters and are summed up again in the first few paragraphs of this chapter. A comprehensive summary of the laws and state practices of the countries of South Asia has been given in the preceding chapters. Every attempt has been made to ensure precision as well as brevity. The latest information has been given and it is duly referenced all through with the sources to which it can be traced at a future point of reference. The comments made in the preceding paragraphs do not have the effect of modifying the existing legal framework in any manner whatsoever. It has been stated as it actually is; these comments are only by way of suggestions for action at local or regional levels for improving the existing framework.

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