CHAPTER VII
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CONCLUSIONS

New States and Traditional International Law

The most important change in the world political scene is the collapse of colonialism, a phenomenon which was present with us for several hundred years. The profound transformation in the political structure of the world has taken place in the course of some twenty-five years, from 1940 to about 1965. The political organization of the world today is almost uniformly based on the nation state. When the United Nations was founded, there were less than fifty nation states. Today, there are more than one hundred and sixty. These political developments have not been followed by economic and social transformation. The expanded world society consists of rich and poor nations. Poor countries, which comprise the preponderant majority of States, have legitimate aspiration to change their economic conditions for the

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better. They are no longer willing to remain as passive objects of international law. The new political and social realities of the world situation call for restructuring of international law which was based on needs of powerful, rich and industrial states of Western Europe and the United States. This law sanctioned exploitation of the dependent territories and would not allow their emergence as economically viable entities.

The newly independent states resent the application of double standards viz. reliance by the advanced capital-exporting countries on the binding character of the transactions forced upon them during the colonial period and, at the same time, denial of the use of force by them as a lawful means of uprooting these arrangements.

Demands for Change in International Law

Change is the inevitable law of life. Law must change with the changing conditions of international commerce and economic relations.
Rules relating to responsibility of states for treatment of alien property cannot remain immune to this dictum. These rules, as developed in the past by the self-declared superior races and addressed to the supposed inferior peoples, stand in the way of the third world countries achieving new international economic order. Political independence attained by these countries would be incomplete unless they also accomplish economic independence and are able to discharge increased responsibilities of a modern welfare state. It is, therefore, essential to put not only colonialism but also neocolonialism to an end.

The right of economic self-determination is being legitimately invoked by the newly independent and other capital-importing states in the pursuit of their economic development. Their struggle for control over natural resources has led them to expropriate alien property. While nobody questions their right of expropriation, international law imposes impossible conditions
for the exercise of this right which the developing countries of the third world cannot accept. Recent developments within and outside the United Nations clearly demonstrate that the problem of expropriation of foreign property constitutes an important segment of the North-South dialogue concerning new international economic order.

During the past few decades, many countries of Asia, Africa and Latin America have embarked upon changes in their economic systems including nationalization of foreign property. To avoid obligations arising out of their actions States have sometimes hesitated to have direct resort to nationalization or expropriation and have sought to achieve their objectives by other means.

The Concepts of Expropriation and Nationalization

State practice thus reveals that taking of foreign property may be either direct or indirect. Nationalizations, expropriation,
requisition and confiscation belong to the former category. In the latter category fall such state actions which apparently are not aimed at depriving a person of his property but in practice bring about the same result. Such takings have been variously described as constructive, creeping or de facto expropriations. Thus, forced sale, forced abandonments, such as in Uganda or Burma affecting Indian nationals, exorbitant taxation, prohibition of dividend distribution, freezing of assets, monetary depreciations or devaluations etc. belong to the category of indirect takings. These measures by the States can effectively deny the aliens use and enjoyment of their property. The distinguishing feature of such measures is generally to disavow any claim for compensation.

Direct taking by a State of alien property is generally in the form of nationalization or expropriation. Nationalization denotes measures involving structural changes in the economic and social system of a country for bringing about
general reforms. It is aimed at excluding private capital from a particular sector of national economy. An expropriation, on the other hand, is confined to particular property of specified individuals. The common effect of both the measures is to transfer private property into the public domain for benefit of the public. According to overwhelming trend of opinion the main difference between the two concepts is that in the case of nationalization partial compensation may be paid, whereas in the expropriation cases full compensation is payable.

In 1938, Mexico even took the stand that no compensation need be paid for expropriations of general and impersonal character. The Charter of Economic Rights and Duties of States (Article 2), recently adopted by the General Assembly, does not appear to make any difference between the two concepts. Although the Charter is not a complete code on the nationalization question and incorporates only a general principle, the use of the expression "appropriate compensation"
in respect of both the concepts might in due course obliterate the distinction between them from the point of view of compensation.

Under traditional international law a taking without compensation was held confiscatory and unlawful. A sizeable group of jurists does not agree with this view today. According to this shade of opinion, which is certainly not without merit, mere lack of compensation need not render a nationalization confiscatory unless the motive behind such measure is penal.

Concession Contracts

Investment through concession contracts is an important segment of foreign investments. There have been several cases of premature termination of concessions. Harvard Draft on Responsibility of States for Injuries to the Economic Interests of Aliens and a few other jurists have taken the view that concession contracts do not constitute property rights. We
do not support this view. Concession contracts can be modified by a State action in the same way as any other property rights. Concession contracts cannot be treated as international agreements. The governing law of the concessions must coincide with the economic milieu of the place where they operate. Hence there is no bar to expropriation of concessions in accordance with the local law.

Pre-independence Concessions and Permanent Sovereignty over Natural Resources

A distinction must be made between pre-independence and post-independence concessions. During the colonial period concessions were obtained by foreigners for absurdly low prices. It was not uncommon for foreigners to win long-term concessions for almost nothing (by offering small presents to the illiterate chieftains and sometimes by exercising even coercion). Therefore, there is no moral or legal justification for denying the
States competence to unilaterally terminate such concessions which are merely economic vassalages. Concessions could be terminated on several grounds, such as economic necessity, change of circumstances, loss of economic disequilibrium, as well as for want of equivalence of advantages. The plea that concessions should not be unilaterally terminated is a plea to freeze them in favour of the concessionnaire in whose favour they are overwhelmingly weighted. The General Assembly Resolution 1803 (XVII) of 14 December 1962 clearly favoured different treatment of concessions of the colonial period in the matter of payment of compensation upon expropriation. It is a logical corollary of the distinction between pre-independence and post-independence concessions that payment of compensation should be left to the judicious discretion of the concerned State expropriating concession of the colonial era. Another ground for distinguishing pre-independence concessions from post-independence concessions
would be on the analogy of *tabula rasa* rule as applied to succession of newly independent States to treaties concluded during colonial regime. The Vienna Convention on Succession of States in Respect of Treaties (1978) includes an article which exempts newly independent States from succession to treaties concluded by the colonial rulers. There appears to be no reason why the same rule should not be applied with respect to concession contracts which are obviously not more solemn than the treaties. Bedjaoui, Special Rapporteur in the International Law Commission on Succession of States in respect of matters other than Treaties, goes further and asserts that agreements which violate economic independence and the right of self-determination of States are void *ab initio*. According to him, formal denunciation of such agreements is not essential. Although we are not in favour of going as far as Bedjaoui does, we are against State's competence to unilaterally alter these concessions being subjected to international adjudication processes.
It is generally argued that acquired rights of the aliens must be respected. In the case of pre-independence concessions, the doctrine of acquired rights may be said to have its counterpart in the doctrine of reversion to sovereignty although it has been invoked only on a limited scale by some of the newly independent states to regain control over their natural resources. The right of economic self-determination, however, should be considered a more potent weapon in the hands of these States.

Post-independence concession contracts, also referred to as economic development agreements, as distinguished from pre-independence concessions, should be generally respected. However, it would be desirable to have a mechanism for renegotiation incorporated in these contracts. This would ensure greater viability of the concession contracts by facilitating elimination of financial imbalances as well as avoid precipitate expropriation by the State.
As noted earlier, the sovereign right of a state to expropriate alien property is generally recognized. What has given rise to controversy is the limitations subject to which this right may be exercised. Among the limitations contested vehemently by developing countries of Latin America, Asia and Africa is the requirement of "due, prompt and effective compensation" traced back to United States Secretary of State Hull's statement. This formula is founded on concepts of "unjust enrichment" and "minimum standard of international law". The principle of unjust enrichment, which is described as a general principle of international law, is biased in favour of private investors as against the community and is also open to manipulation. Similarly, the principle of international minimum standard reflects no more than nationalism of capital-exporting countries in the garb of internationalism.
"Due, Prompt and Effective" Compensation

The "due, prompt and effective" compensation formula generally implies that full market value of the property must be paid in all cases of expropriation or nationalization. To the extent a taking falls short of full compensation it is considered confiscated. Further, under the formula the compensation to be prompt should be paid prior to the act of taking. If the payment is deferred to a later date interest is payable till the compensation has been fully paid. For meeting the requirement of effective compensation it has to be in the currency of the claimant state or in a freely convertible currency. There is no unanimity even among the Western publicists as to the content of the "due, prompt and effective" compensation formula. Thus, promptness is defined to mean "payment as soon as is reasonable under the circumstances". Several Western writers are also prepared to reduce the rigor of the formula by conceding that condition of adequacy of
Adequate compensation would be met if partial compensation is paid in cases involving general expropriations or extensive takings. The interpretation of "effective" compensation varies from requirement of payment in creditor State's currency to that of the taking State's local currency. There is also a view that effective compensation can be paid in the form of goods and services instead of currency. The traditional compensation formula is thus indeterminate. It is also inflexible inasmuch as a taking is considered unlawful if requirements of a traditional compensation formula are not met.

The viewpoint represented by the developing countries denies the existence of "due, prompt and effective" compensation rule as a rule of customary international law since legal precedents and opinions differ widely.
The rule is considered unfair to the developing countries because a large number of them inherited burdensome regimes of acquired rights held by the aliens. They look at this formula with distrust which, in their view, is aimed at perpetually preserving the colonial privileges. Being poor, most of these countries lack the capacity to pay full compensation at market value and, therefore, have to choose between foregoing nationalization of alien property or preserving unequal privileges if they were to follow "due, prompt and effective" compensation formula. Further, application of the formula would be inequitable where foreign investors have made profits many times more than their investments.

Lump-Sum Settlements

The credibility of the orthodox compensation formula appears to have been greatly affected by the lump-sum settlements concluded after Second World War. Compensation paid under these agreements rarely conforms to requirements
of the traditional formula. Since in lump sum settlements all individuals' claims are not verified, payment of full compensation is ruled out. These settlements constitute a significant departure from the traditional compensation formula. The safest conclusion one can draw from these settlements is that states expropriating or nationalizing foreign property are under an obligation to pay at least some compensation. The percentage of compensation paid has varied from agreement to agreement. The negotiations are often conducted in secrecy and in most of the cases it is difficult to work out the percentage unless one knew the amount of compensation claimed. At the end of the negotiations one comes to know only about the amount actually paid as compensation. In any case, it would be difficult to agree with the school of thought represented by Bystricky and others who regard lump-sum settlements as merely making ex-gratia payment?

Lump-sum settlements strike a serious blow on another important limb of the traditional
compensation formula, namely, prompt compensation. Most of these settlements provide for payment of compensation in instalments. Further, there is no uniform practice regarding payment of interest on deferred compensation. Instances also exist in which compensation was paid only in kind and not in cash.

A significant and influential section of the Western publicists has moved away from the traditional compensation formula and has backed more moderate and middle-of-the-road standard of compensation. A few jurists have expressed the view that there is no obligation to pay any compensation unless there is a treaty to that effect. This school of thought is clearly in a minority.

**The Problem of Compensation and Recent Developments**

Most of the developing countries, while not denying that some compensation should be paid
upon expropriation, contend that the matter is within their domestic jurisdiction. This view was only partially accommodated in the General Assembly Resolution 1803 (XVII) of 14 December 1962 which provided that in case of nationalization or expropriation the owner shall be appropriately compensated "in accordance with rights in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law". In the subsequent developments reference to "international law" has been completely omitted. Thus Resolution 3171 (XXVIII) of 17 December 1973 provides that the amount of "possible compensation" should be settled in accordance with the national legislation of each State. Article 2 of the Charter of Economic Rights and Duties of States makes provision for payment of appropriate compensation in the light of relevant laws and regulations of the nationalizing State. Any controversy on the question of compensation is required to be settled under the "domestic law of the nationalizing State and by
its tribunals". All these developments, in our view, formally announce the demise of "due, prompt and effective" compensation formula. New international law needs to be developed taking into account realities and characteristics of the modern world.

Public Purpose and Non-Discrimination

Besides compensation, the other two limitations in traditional international law on a State's right to expropriate foreign property are requirements of public purpose and non-discrimination. Although it is difficult to establish objective criteria for determining the existence of public purpose in an expropriation, it would not be prudent to abandon it. The requirement of public purpose has not been expressly mentioned in the Charter of Economic Rights and Duties of States but most of the countries provide for it in their national Constitutions. Moreover, virtually no opposition
has been voiced or heard against this principle in state practice or juristic opinions. Support of the world community to this principle may, therefore, be assumed.

The application of non-discrimination principle, though not disputed to the same extent as the compensation formula, has also been challenged particularly in cases of initial inequality arising out of colonial situations e.g., where a given business happens to be largely in the hands of foreigners. Further challenge to this principle has come from recent demands of the developing countries for preferential treatment in matters of trade and investment. This does not lead to the conclusion that the principle of non-discrimination has been discarded. What it does indicate is that emphasis on the principle is less marked.
Local Remedies Rule

In view of the fact that traditional compensation formula is unlikely to be respected by a majority of the developing countries, the importance of the local remedies available under laws of the States undertaking expropriation need hardly be overemphasized. The local remedies rule is a general principle of international law supported in state practice and judicial decisions. The International Law Commission which is currently codifying rules on state responsibility has included it in its draft articles. An alien whose property has been expropriated is under an obligation to exhaust local remedies in the first instance. This rule is closely related to the development of international obligations regarding the treatment accorded by a State to foreigners and their property. According to the dominant view, and the rule as framed by the International Law Commission, the local remedies principle is not merely a rule of procedure but substance.
Thus the rule operates at the level of determination of the existence of a breach of an international obligation. The distinction between substantive and procedural nature of the rule could have practical importance for the capital-exporting countries. If the rule is considered substantive, compensation for expropriation will have to be calculated from the time of the injury. This is based on the premise that cause of action arises only after the exhaustion of local remedies. According to the International Law Commission, however, for purposes of determining the amount of compensation (and interest thereon) it is permissible on the basis of justice and equity to take the first act as the basis of injury.

The merit of the local remedies rule is that it helps to localize the conflict and prevents it from escalating into an international dispute. Being based on sovereign equality of states it satisfies the ego of sovereign states and allows
one of its own organs to judge the validity of their action. Local courts which an alien is likely to approach for redress are best suited to uphold the objectives and values behind expropriation of foreign property. The only drawback of the local remedies rule (if it may be called a drawback) is alien's lack of confidence in the local processes. Some observers feel that the role of local remedies rule has largely eroded in the field of expropriation as a result of the lump-sum settlements. This does not appear to be wholly correct since the number of lump-sum settlements is far less than the actual cases of expropriation or nationalization.

**Denial of Justice**

If in the state expropriating alien property a judicial situation exists in which an alien is unable to exhaust local remedies it amounts to denial of justice. For political as well as practical reasons the developing countries
have always tried to keep the scope of "denial of justice" restricted to denial of access to courts without going into the merits of a decision adverse to the alien. On the other hand, the developed countries have sought to enlarge its meaning to cover failure of legislature to provide remedies or irregularities on the part of other organs of the State. Those supporting extended meaning of "denial of justice" are not unanimous as to where the line should be drawn. Since legal and economic systems in the world differ widely, any attempt to enlarge the meaning of this term will, in our view, only result in uncertainty without leading to an agreed meaning.

**Diplomatic Protection**

Not infrequently, a liberal interpretation of "denial of justice" has led the powerful States to resort to diplomatic protection. This gave rise to illegal interference by these States in the domestic affairs of weaker States to protect foreign investments as well as other exaggerated
claims by their nationals and even gave rise to
military aggression against them. Abuses of the
right of diplomatic protection forced the Latin
American States, which were often the victims
of this practice, to devise what is popularly
called Calvo doctrine. The legal basis of the
right of diplomatic protection that a State itself
is injured if an injury is caused to its nationals
is questioned by many jurists on the ground that
the individual concerned is the ultimate object
of protection and that diplomatic protection
converts a private claim into a national one.
The main objection to the institution of diplomatic
protection is that it amounts to right of appeal
from local remedies.

Calvo Doctrine and Recent Developments

According to the Calvo doctrine an alien
whose property has been expropriated can claim no
greater protection than the national of the
expropriating State. If an alien gets national
treatment he is not entitled to seek diplomatic
protection of his home State. On the other hand,
the developed capital-exporting states have always taken the view that if national standard does not measure upto international standard of treatment there would be justification in their taking up the claim diplomatically.

As already observed, recent developments in the United Nations General Assembly, such as Resolution of 1973 and the Charter of Economic Rights and Duties of States, have declared the domestic courts of states expropriating alien property as the final arbiters on disputes concerning payment of compensation. Western publicists consider that these are attempts to endow the Calvo Clause with an international status as well as to deny alien claimants the right to seek diplomatic protection of their states. This fear is not well-founded since the concept of denial of justice has not been abolished. It would appear that it is not diplomatic protection which is the main target of attack by the General Assembly resolution or the Charter of Economic Rights and Duties of States, but the so-called international standard of treatment. It is,
however, probable that these developments in response to demands for a new international economic order will bring about a qualitative change in the application of diplomatic protection.

Calvo Clause

The Calvo doctrine gave birth to the Calvo Clause which was used and even now continues to be used by the Latin American States to seek contractual waiver of diplomatic protection by alien concessionnaires making investments in those countries. Although some jurists have contested the right of individuals to waive by a contract the right of their State to diplomatically protect them, the validity of the Calvo Clause has been confirmed by several claims Commissions. It also received support in the Asian-African Legal Consultative Committee from some members and has been given limited effect in the Joan-Baxter Draft Convention on Responsibility of States for Injuries to Aliens. García-Amador, a former Special Rapporteur on State Responsibility in the International Law Commission, seems to have
fully supported this clause. The Calvo Clause was inserted in an agreement of 1968 between Peru and International Petroleum Corporation. In our view, since the Calvo Clause is inserted in a contract by free will of the parties, legally or morally there is nothing reprehensible about it.

In view of the fact that we consider pre-independence concessions voidable at the option of the states it would seem logical to exclude them from the purview of diplomatic protection.

It would, not, however, be advisable to altogether do away with the institution of diplomatic protection in all cases of expropriation or nationalisation.

Protection of Foreign Property

Several attempts have been made on a multilateral level also, to afford protection to foreign investments and property. The earliest attempt was made in the Havana Charter for the
International Trade Organization drawn up in 1948 but the Charter was abandoned in favour of the General Agreement on Tariffs and Trade (GATT) which does not deal with the protection of property. A general economic agreement drafted by the United States and the republics of the American Hemisphere at the Bogota Conference, 1948, a Code of Fair Treatment for Foreign Investments drawn up by the International Chamber of Commerce in 1949, the initiative of the Prime Minister of Malaysia in March 1958 at the fourteenth session of the United Nations Economic Commission for Asia and the Far East for an international investment charter, Abs-Shawcross Draft Convention on Investments Abroad (April 1959), all seem to have largely failed. The substantive provisions of the Abs-Shawcross Convention were toned down and a Draft Convention on the Protection of Foreign Property was prepared in 1962 by the Organisation for European Economic Co-operation and Development (OECD) followed by another version in 1967. After these abortive efforts, the International Bank
for Reconstruction and Development stepped in and succeeded in finalizing a Convention on the Settlement of Investment Disputes between States and Nationals of other States which entered into force on 14 October 1966. As of 22 September 1978, seventy-seven States had signed this Convention and seventy-one States deposited instruments of ratification. The World Bank could achieve success because emphasis in the Convention was laid on procedural rather than substantive aspects which enabled capital-importing States not to commit themselves to any substantive rules. However, the success of the Convention could be described only limited. A number of important capital-importing States, such as Burma, India, Iran, Phillipines, Spain, Thailand, Turkey and nearly all the Latin American countries, have failed to sign the Convention. As of 3 January 1978, eight arbitration cases were brought before the International Centre for Settlement of Investment Disputes out of which award was rendered only in one case on 29 August 1977. Four proceedings were discontinued, one is continuing and in the other two, Tribunals have still to be constituted.
In addition to the above efforts, the World Bank is also endeavouring to establish an International Investment Insurance Agency. This effort is yet to mature.

Apart from the above mentioned attempts for the protection of foreign property, capital-importing countries have from time to time concluded investment guarantee agreements with capital-exporting states in order to attract foreign capital.

Need for Universal Consensus

Notwithstanding the aforesaid efforts for protection of foreign property, it will be difficult to rule out cases of expropriation thereof so long as economic conflicts and problems of poverty exist. The task of working out a comprehensive and universal convention on substantive rules regulating the treatment of foreign investments is herculean and chances of such an attempt being successful are quite
limited. An important factor militating against this is that different developing countries have different investment problems. They may have good reasons for adopting different policies for the treatment of foreign investments. Therefore, the concerned capital-exporting and capital-importing states may find it more convenient to conclude bilateral agreements on treatment of alien property. This will also be necessary in view of the fact that traditional international law in the matter has undergone change and contemporary international law is still in a state of flux.

One of the imperatives of new international economic order is to enlarge collective self-reliance among the developing countries through trade liberalization measures and utilization of know-how, skills, natural resources, technology and funds available within these countries. Therefore, there appears to be a need for norms governing their relations inter se including norms for treatment of
foreign investments. They might try to develop these norms at bilateral or regional level. The principles which culminated as an expression of right of self-determination of the States and as a reaction to the colonial exploitation of the resources of the poor by the rich or as a result of interventionist policies of some States may not be suitable to regulate relations between them.

In the meanwhile, efforts for a worldwide consensus on various problems raised above must continue.