University of Alberta

Canada's Foreign Direct Investment Legislation and Treaties as Models for Albania and Croatia

by

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ABSTRACT

The main argument of this thesis is that generally accepted legal principles and standards regulating FDI in Canada serve as a good example and model for the revitalization and recovery of Albania and Croatia. By analyzing the Canadian domestic legislation and bilateral investment treaties (BITs) negotiated by Canada in the area of FDI and international trade, on the one hand, and by comparing these instruments to the current situation involving FDI developments in Albania and Croatia, on the other hand, suggestions and recommendations for reform of FDI-related laws and BITs in Albania and Croatia will be offered, based upon the theoretical and practical approaches to these issues and the effectiveness and the convenience of their implementation.

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CONTENTS

ABBREVIATIONS AND ACRONYMS

AEDA	Albanian Economic Development Agency
ANIH	Albanian Foreign Investment Promotion Agency
ASEAN	Association of South East Asian Nations
BITs	Bilateral investment treaties
CEFTA	Central European Free Trade Agreement
CFIUS	Committee on Foreign Investment in the United States
CMEA	Council of Mutual Economic Assistance
CUFTA	Canada-United States Free Trade Agreement
DPA	Democratic Party of Albania
EFTA	European Free Trade Association
EU	European Union
FCNs	Treaties of Friendship, Commerce and Navigation
FDI	Foreign Direct Investment
FIPAs	Foreign Investment Promotion and Protection Agreements
FIRA Agency	Foreign Investment Review Agency
FIRA	Foreign Investment Review Act
FRY	Federal Republic of Yugoslavia
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
FYROM	Former Yugoslav Republic of Macedonia
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IBB	Invest in Britain Bureau
IC Act	Investment Canada Act
ICJ	International Court of Justice
ICR	Investment Canada Regulations
ICSID	International Center for Settlement of Investment Disputes
ICTY	International Criminal Tribunal for the Former Yugoslavia
IMF	International Monetary Fund
IP	Intellectual Property
MERCOSUR	Mercado Comun del Sur, or Common Market of the South
MFN	Most-Favoured Nation
MIGA	Multilateral Investment Guarantee Agency
MNEs	Multinational Enterprises
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
OECD	Organisation for Economic Co-operation and Development
OSCE	Organization for Security and Cooperation in Europe

SAA	Stabilization and Association Agreement
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USSR	Union of Soviet Socialist Republics
USTR	Office of the United States Trade Representative
WB	World Bank
WTO	World Trade Organization
WWI	World War I
WWII	World War II

CHAPTER I

INTRODUCTION

Foreign Direct Investment (FDI) is one of the main factors that influence contemporary world trade and global economic development. "About one third of the US$6.1 trillion total for world trade in goods and services in 1995 was trade within companies,"[1] between various types of investments. More recently, the flow of FDI in the world in 2003 reached the amount of US$650 billion."[2] According to the United Nations Conference on Trade and Development (UNCTAD), the general assessment for FDI prospects for 2004-2007 is also very optimistic.[3]

Even though FDI seems to be the main engine that drives the world economy, there is still no single consistent world-wide definition of FDI. Various authors agree that FDI is that type of investment which guarantees the maximum control over the activity of a company during a relatively long period of time, distinguishing it from other types of investments, such as investments in real assets (gold or real estate) and

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[1] Understanding the WTO: Cross-Cutting and New Issues - Investment, Competition, Procurement, Simpler Procedures, online: World Trade Organization <http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm> (accessed March 14, 2005).

[2] UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (New York and Geneva: United Nations, 2003) at iii.

[3] UNCTAD, *Prospects for FDI Flows and TNC Strategies, 2004-2007* (Sao Paulo: United Nations, 2004) at 2.

financial assets (paper or electronic claims on some issuer, most often a federal or provincial government).[4] However, the actual description of the essence of FDI varies considerably in the reports of international organizations or in the legislation of individual countries.

Inward FDI constitutes the flow of investment coming into the economy of a country from abroad, while outward FDI refers to the reverse phenomena, in which the flow of investment is directed outside the economy of a country. The country that is the recipient of the FDI is named the host state and the country in which the FDI originates is referred to as the home state.[5]

The main focus of this thesis is to explore the Canadian international and domestic law models regulating FDI and prescribe suitable models for the South East European economies of Albania and Croatia. I will identify the main principles and standards that characterize the treaties and legislation regulating FDI with regard to Canada. Then, I will compare the Canadian model to investment legislation and

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[4] E.g. William S. Cleary & Charles P. Jones, *Investments: Analysis and Management* (Ontario: John Wiley & Sons Canada, 2000) at 3 and M. Somarajah, *The Settlement of Foreign Investment Disputes* (Cambridge: Kluwer Law International, 2000) at 4.

[5] For a complete glossary of FDI terms and definitions, see *Glossary of Foreign Direct Investment Terms and Definitions*, compiled by the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF), OECD: Publications and Documents, online: World Trade Organization, Glossary of Foreign Direct Investment Terms and Definitions <http://www.oecd.org/dataoecd/56/1/2487495.pdf> (accessed March 14, 2005).

economic circumstances in the post-Communist emerging democracies of Albania and Croatia, in order to analyse positive achievements and point out gaps or negative developments in these countries.

Albania and Croatia will be the two case study countries in this thesis for several reasons. Albania serves as a case study country because it was the first country of South East Europe to adopt legislation on foreign investment, at a time when the largest part of the region was engulfed in civil and ethnic wars.[6] In 1991-1993, Albania set the pace for reform in this region of Europe by adopting modern legislation and attracting a relatively good number of investors.[7] On the other hand, Croatia is economically more developed than the rest of South East Europe,[8] and has made greater progress on the road towards entry in the European Union (EU)[9] and other European institutions. Albania and Croatia have had similar histories under the Communist regime.[10] Further, both Albania, after the collapse of Communism, and

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[6] See e.g. law "On Foreign Investments", Law No. 7594, Aug. 4, 1992, Official Gazette No. 4.

[7] See Scott Norman Carlson, "Foreign Investment Laws and Foreign Direct Investment in Developing Countries: Albania's Experiment" (1995) 29 Int'l L. 577 at 596; Mike Shallcross, "Europe's Fastest Growing Location" *Corporate Location* (November/December 1994) 24 at 24.

[8] Letica Bartol, "Europe's Second Chance: European Union Enlargement to Croatia and the Western Balkans" (2004) 28 Fletcher F. World Aff. 209 at 217.

[9] Croatia signed the Stabilization and Association Agreement (SAA), which is the first step toward joining the EU in October 2001, while submitting the actual application for EU membership in 2003. Croatia is hoping to join the EU as a full-fledged member in 2007. *Ibid.*

[10] James F. Brown, *Eastern Europe and Communist Rule* (Durham and London: Duke University Press, 1988) at 1.

Croatia, after the end of the war with Yugoslavia, fell into a state of semi-authoritarianism.[11] Both countries seem to have achieved a certain level of stability since 2000 and are making comparable achievements in their efforts toward integration into European institutions.[12]

My argument is that generally accepted legal principles and standards regulating FDI in Canada serve as a good example and model for the revitalization and recovery of Albania and Croatia. By analyzing the Canadian domestic legislation and bilateral investment treaties (BITs) negotiated by Canada in the area of FDI and international trade, on the one hand, and by comparing these instruments to the current situation involving FDI developments in Albania and Croatia, on the other hand, I will offer suggestions and recommendations for reform of FDI-related laws and BITs in Albania and Croatia based upon the theoretical and practical approaches to these issues and the effectiveness and the convenience of their implementation.

Canada is used as an example and model for Albania and Croatia because Canada has been faced with large amounts of inward and outward FDI since the birth of the nation in 1867,[13] accumulating a vast experience in domestic legislation dealing with FDI. For the most part, Canada has overall maintained an economic liberal point of view toward FDI and its role in the economy, alternating policies of

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[11] Marina Ottaway, *Democracy Challenged – The Rise of Semi-Authoritarianism* (Washington, D.C.: Carnegie Endowment for International Peace, 2003) at 111-112.

[12] See *infra* Chapter IV, text accompanying notes 132 and 137.

[13] See *infra* Chapter II, text accompanying notes 11 to 15.

economic nationalism with those of economic liberalism.[14] During the last decades, Canada has negotiated numerous Foreign Investment Promotion and Protection Agreements (FIPAs) and Free Trade Agreements (FTAs) with developing countries,[15] including the 2004 Canadian Model FIPA,[16] accumulating the latest advancements in international law on FDI. As Albania and Croatia are in the initial stages of economic development and their experience with FDI is quite limited,[17] these two countries can benefit considerably from the Canadian experience in dealing with inward and outward FDI and they should follow those economic policies that are most suitable for their existing conditions and future development.

Canada, as one of the most industrialized and developed countries in the world (Canada is the world's seventh-largest market economy),[18] has gone through several interesting developments with regard to FDI, especially after World War II (WWII). From the international political economy standpoint, the Canadian government, traditionally, has alternated policies of economic nationalism with those of economic liberalism. Economic nationalism requires the state to be capable of existing and functioning efficiently on its own, without any aid or assistance from abroad, and also advises the enactment of regulations and laws that restrict the

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[14] See *infra* Chapter II, text accompanying notes 71 to 79.

[15] See *infra* Chapter II, text accompanying notes 168 to 181.

[16] See *infra* Chapter III, note 82.

[17] See *infra* Chapter IV, text accompanying notes 128 to 132.

[18] US Embassy Ottawa, *US Department of State, FY 2001 Country Commercial Guide: Canada* (Washington, D.C.: United States Government Printing Office, 2001) at 7.

activity of private enterprises, whether domestic or international.[19] In the global competition of nations against nations, a country's balance of trade must be favourable; the country must have more exports than imports.[20] This theory, also known as "Mercantilism" was the primary school of economic thought in Europe from the sixteenth to the eighteenth century.[21]

Signs of economic nationalism can be found in Canadian economic policy since the birth of the nation in 1867, beginning with Prime Minister Macdonald's high tariffs in 1874,[22] followed by the National Policy in 1878.[23] The latest revitalization of economic nationalism in Canada was obvious in the transformation of the policy by the government of Canada in the late 1960s and early 1970s,[24] and reached its peak with the enactment of the *Foreign Investment Review Act* (FIRA) in 1973.[25] The introduction of FIRA[26] in 1973 re-emphasized Canadian nationalism and

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[19] George Macesich, *Economic Nationalism and Stability* (New York: Praeger Publishers, 1985) at 2.

[20] *Ibid.* at 27. For a detailed analysis of the original theory of economic nationalism see generally Thomas Mun, *England's Treasure by Foreign Trade* (Oxford: Blackwell, 1928). See also Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987).

[21] Macesich, *ibid.* at 22.

[22] See *infra* Chapter II, note 19.

[23] See *infra* note 27 at 215.

[24] Wallace Clement & Glen Williams, eds., *The New Canadian Political Economy* (Montreal: McGill-Queen's University Press, 1989) at 3.

[25] S.C. 1973-1974, c. 46, as am. S.C. 1976-1977, c. 52, s. 128.

[26] See *infra* Chapter II, note 40 at 517.

its political and economic goals of Canadian control over the major foreign companies active in Canada by screening and limiting FDI in Canada.[27] It was the climax of Canadian concerns with foreign domination, especially American, in strategic sectors of the Canadian economy.

However, because of Canada's close trade relationship with the United States (US), the large influence of the US on the Canadian economy,[28] and the changing policies of the Canadian government, Canadian economic nationalism has alternated with periods of time where economic liberalism has ruled the political agenda of the Canadian government. Economic liberalism advocates a very limited role for the government in the economic dynamics of the market.[29] Its classic ideologists, Smith and Ricardo, suggested that a market can reach its maximum growth only when left alone, without the intervention of the government.[30] The government should only play the role of the guardian of the rules of fair competition and fair trade, as well as guarantee justice and maintain public order.[31] The evolution of economic liberalism

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[27] Charles J. McMillan, "After the Gray Report: The Tortuous Evolution of Foreign Investment Policy" (1974) 20 McGill L. J. 213 at 213-214.

[28] See *infra* Chapter II, note 40 at 517.

[29] *Supra* note 19 at 36-37.

[30] *Ibid.* at 40. For a detailed analysis of the original theory of economic liberalism see generally Adam Smith, *The Wealth of Nations* (New York: Random House, 1991) and David Ricardo, *On the Principles of Political Economy and Taxation* (London: John Murray, 1821).

[31] Richard F. Hamilton, *Marxism, Revisionism and Leninism: Explication, Assessment and Commentary* (Westport: Praeger Publishers, 2000) at 15, 18.

in the policies of the Canadian government is found in its adherence to the General Agreement on Tariffs and Trade (GATT) in 1948,[32] membership in the World Trade Organization (WTO) since 1995[33] and the adoption of the Investment Canada Act (IC Act) in 1985,[34] followed by the Canada-United States Free Trade Agreement (CUFTA) and the North American Free Trade Agreement (NAFTA),[35] and other free trade agreements entered into by Canada. The IC Act sought to reverse some of the negative trends resulting from FIRA and assist in the increase, once again, of the flow of FDI into Canada, focusing more on economic liberalism.

In the international sphere, Canada has been very active in signing numerous FIPAs Foreign Investment Promotion and Protection Agreements (FIPAs) (otherwise known as BITs) with many countries of different economic and political systems.[36] The CUFTA, which entered into force on January 1, 1989, and especially Chapter 11 of NAFTA, in force since January 1, 1994, took the FDI developments in Canada to

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[32] General Agreement on Tariffs and Trade, October 30, 1947, Can. T.S. 27/1947, T.I.A.S. No. 1700, 55 U.N.T.S. 187.

[33] General Agreement on Trade in Services, April. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts 325, 33 I.L.M. 1168 (1994). The GATT is incorporated in the WTO Agreement.

[34] *Investment Canada Act*, R.S.C. 1985, c. 28, s. 2.

[35] *North American Free Trade Agreement between the Government of the USA, the Government of Canada and the Government of the United Mexican States*, United States, Canada and Mexico, 17 December 1992, CTS 1994/2. The CUFTA is suspended while the NAFTA is in force.

[36] See *infra* Chapter III, text accompanying notes 74 to 88 for detailed discussions on FIPAs.

another higher level. One of the main objectives of NAFTA is to facilitate and encourage US and Canadian investments in Mexico,[37] bringing together two largely industrialized countries and one developing country. Today, NAFTA accounts for a GDP of US$11.4 trillion, about one-third of the world's total,[38] C$1.9 billion of goods and services cross the Canada-US border every day[39] and, since 1989, Canada-US trade has nearly tripled from C$235.2 billion to C$677.8 billion in 2002.[40] NAFTA is also extremely important as it contains a complete chapter on FDI between the NAFTA parties, investment protection and a dispute resolution mechanism between NAFTA investors and NAFTA host countries.[41]

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[37] Brenda M. McPhail, ed., *NAFTA NOW: The Changing Political Economy of North America*, (Lanham: University Press of America, 1995) at vii. Under NAFTA Article 102 – Objectives, the elimination of barriers to trade and increase in investment opportunities in the territories of the Parties are mentioned as main objectives of this agreement, *supra* note 35.

[38] Department of Foreign Affairs and International Trade, *NAFTA @ 10: A Preliminary Report* (Ottawa: Minister of Public Works and Government Services Canada, 2003) at 3.

[39] *Ibid.*

[40] *Ibid.*

[41] See NAFTA Chapter 11, *supra* note 35; Howard Mann, "*Private Rights, Public Problems: A Guide to NAFTA's Controversial Chapter on Investor Rights*" (Winnipeg: International Institute for Sustainable Development, 2001) at 21.

Albania and Croatia (the latter as one of the six republics of Yugoslavia)[42] followed quite a different path after WWII than Canada. Communism ruled in these countries for almost half a century and these states were subjected to an application of the Marxist theory on economics and the state.[43] The political economy aspect of Marxism[44] claims that "society is economically determined".[45] In this regard, Marxism rejects all types of private property, which is considered as the root of all evil and conflicts in capitalistic society.[46] This theory requires the state to have an absolute monopoly over all economic activities and to provide for specific centrally-administered plans of development and growth.[47]

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[42] Elizabeth M. Cousens, "Making Peace in Bosnia Work" (1997) 30 Cornell Int'l L.J. 789 at 790. The six republics were: Croatia, Serbia, Bosnia-Herzegovina, Slovenia, Montenegro and Macedonia, while the two autonomous regions were Kosovo and Vojvodina.

[43] *Supra* note 10. For a longer and detailed discussion of Communism in Eastern Europe see generally Robert Bideleux & Ian Jeffries, *A History of Eastern Europe: Crisis and Change* (London: Routledge, 1998).

[44] "Marxism" is a theory of political economy developed by Karl Marx (1818-1883) and Friedrich Engels (1820-1895).

[45] Michael McQuade, "Deconstruction and Marxism: Implications for Law and Society" (1992) 1 Dalhouise J. Legal Stud. 87 at 93.

[46] Alice Erh-Soon Tay & Eugene Kamenka, "Marxism, Socialism and the Theory of Law" (1984-1985) 23 Colum. J. Transnat'l L. 217 at 232.

[47] Angus Walker, *Marx: His Theory and its Context* (Winchester: Rivers Oram Press, 1989) at 144-145.

In Eastern Europe, all manufacturing property was nationalised within the first years after the end of WWII.[48] Central planning followed, in which every operation of all enterprises was controlled by the state as were the wages and the prices of practically all commodities.[49] The centralized and planned economic policies, state-run factories and plants, as well as the hostile and isolationist political policies barred the fulfilment of the economical potential of the region. After the collapse of Communism in the early 1990s, some of the countries in South East Europe plunged into civil and ethnic wars (Bosnia-Herzegovina, Croatia, Former Yugoslav Republic of Macedonia (FYROM) and Serbia-Montenegro), resulting in more poverty, social unrest and economic stagnation.[50] As a result of failed "get-rich-quick" pyramid schemes, Albania was engulfed in armed and violent riots in early 1997, which erased all the gradual economic progress up to that point.[51] Of all of the countries of the region, only Bulgaria and Romania are more advanced in their efforts toward sustainable economic development, free market economy, establishment of the rule of law and democratic institutions, and Euro-Atlantic integration. They have joined the

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[48] Paul J.J. Welfens, *Market-oriented Systematic Transformations in Eastern Europe* (Munster: Springer-Verlag, 1992) at 123.

[49] *Supra* note 10 at 112-114.

[50] Reneo Lukic & Allen Lynch, *Europe from the Balkans to the Urals: The Disintegration of Yugoslavia and the Soviet Union* (New York: Oxford University Press, 1996) at 31. Detailed accounts of Yugoslavian ethnic wars in the 1990s and the crisis that followed are provided in Chapters 9-10.

[51] Hall Gardner, ed., *Central and Southeastern Europe in Transition: Perspectives on Success and Failure Since 1989* (Westport: Praeger Publishers, 2000) at 84.

Central European Free Trade Agreement (CEFTA) and are hoping to become part of the EU in the near future.[52]

In recent years, Albania and Croatia have been trying to attract the capital, technology and management skills of foreign investors.[53] This phenomenon of former Communist countries moving toward a free-market economy and closer to Western Europe institutions can be attributed to four main reasons. First, the devastation and the collapse of the Communist system left these countries in political chaos and economic stagnation, with Croatia experiencing ethnic war.[54] Therefore, it was necessary to adopt a functional economic and political system that would withstand the repetitive crises and offer long-term solutions to everyday problems. What better model than the free-market economy, which had brought prosperity and stability to their Western neighbours? Second, these countries realized the potential of FDI in their countries and understood the need to adopt policies that would transform their domestic economies to the standards of world market so that they could attract the much needed investments.[55] Third, the World Bank (WB) and the

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[52] Central European Free Trade Agreement, Dec 21, 1992, 34 I.L.M. 3 (1995). See also Eneko Landburu, "The Fifth Enlargement of the European Union: The Power of Example" (2002-2003) 26 Fordham Int'l L.J. 1 at 5.

[53] Cheryl W. Gray & William W. Jarosz, "Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe (1995) 33 Colum. J. Transnat'l L. 1 at 5.

[54] *Supra* notes 50 and 51.

[55] E.C. Nieuwenhuys & M.M.T.A. Brus, eds., *Multilateral Regulation of Investment* (The Hague: Kluwer Law International, 2001) at 37.

International Monetary Fund (IMF) have conditioned their assistance programs for restructuring of the Albanian and Croatian economies upon the adoption of liberal policies, in what Sornarajah calls the 'Washington consensus' underlining its notions of economic liberalism,[56] aiming to bring the economies of these countries in harmony with the rest of the world.[57] Fourth, after the 9/11 events, it has become even more critical for these countries to improve their security and thwart the threat of terrorism by joining the strong military organization of the North Atlantic Treaty Organization (NATO), composed of Western country members. Albania and Croatia aspire to become members of NATO in the next wave of enlargement.[58] Therefore, for the above-mentioned reasons, these two countries can benefit from the experience of the FDI laws and treaties of Canada based on a philosophy of economic liberalism.

The examination of Canadian legislation as well as its BITs will reveal many principles and standards that are not only important but also extremely indispensable for the legal structures of a host state before foreign companies or individuals may or will engage in the much-needed investments. The national treatment principle

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[56] M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 2004) at 53.

[57] Kenneth J. Vandevelde, "Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties" (1998) 36 Colum. J. Transnat'l L. 501 at 502. See also Howard Mann, "NAFTA's Investment Chapter: Dynamic Laboratory, Failed Experiments, and Lessons for the FTAA" (2003) 97 Am. Soc'y Int'l. L. Proc. 247 at 249.

[58] NATO: Enlargement, online: NATO <http://www.nato.int/issues/enlargement/index.html#FN> (accessed March 14, 2005).

(foreign investors have equal chances to compete with their domestic competitors), the most-favoured nation principle (treating foreign investors equally with other third country investors), dispute resolution through arbitration (fair, impartial, time-efficient, legally binding and enforceable), and regulation of government expropriation (for a public purpose, on a non-discriminatory basis, in accordance with due process of law and on payment of compensation) are only some of these principles and standards.[59] In addition, more fundamental democratic and economic standards that must be strengthened in Albania and Croatia include the rule of law, democratically-elected institutions, respect for these institutions and their decision-making authority, an independent and impartial judiciary, a stronger free-market economy, a stable and convertible currency and sound financial and fiscal policies and practices.

The establishment and strengthening of the above-mentioned principles and standards in Albania and Croatia will create a favourable environment to attract potential foreign investors and FDI. I will compare the existing domestic legislation and BITs in Albania and Croatia to accepted principles and standards as exemplified by the Canadian model. Best practices will be recommended and suggestions will be provided for overcoming certain obstacles in the way toward attracting as much FDI as possible.

[59] See *infra* Chapter III, text accompanying notes 89 to 97.

Chapter II will cover the history and evolution of FDI, focusing especially on developments after WWII. Regardless of the lack of an exact definition, FDI is a product of the historical, political and economic conditions of all societies at any given time. Consequently, I will examine its evolution taking into account these circumstances. The history of FDI in the US and the United Kingdom (UK) will provide a better understanding of the impact that these two countries have had on the development of the Canadian economy and investment trends. Historically, Canada has been closer to the UK than to the US until the early twentieth century, but because of geographical proximity the US has played a much more important role in influencing and shaping Canada's economy especially in the post-WWII period. I will then discuss the role of FDI in today's world. The main domestic legislation and main BITs will be covered in brief, as they will be reviewed in detail in Chapter III.

In Chapter III, the focus will be on the domestic legislation and BITs effective in Canada. I will study the IC Act, the most relevant provisions of various BITs, as well as NAFTA. Particular attention will be dedicated to Chapter 11 of NAFTA as it is one of the most complete set of investment-related provisions found in an international agreement. I will observe the effects that NAFTA had in changing the format of Canadian BITs, as I analyse BITs based on the old model (which in itself was based on the Organisation for Economic Co-operation and Development (OECD) model).[60] Finally, I will analyze the recent Canadian Model FIPA and the new US Model BIT and their improvements compared to previous treaties. Here I will present

[60] See *infra* Chapter III, text accompanying notes 159 to 181.

principles and standards required for successful inflows of FDI as I identify them from the BITs that Canada has signed with Romania, Croatia, Hungary and other countries of East Europe, and as I see them implemented with regard to Canada.

Chapter IV explores the economic and legal situation of Albania and Croatia. In order to understand more deeply today's challenges I will examine in brief the common background and history of these countries during the years of Communist rule in the region. Then I will discuss the existing economic situation, the state of affairs of FDI, and domestic legislation on FDI and BITs in Albania and Croatia. Current trends and expected potential developments will also be discussed in this chapter. Finally, I will offer suggestions and ideas on how Canadian principles and standards can be applied with regard to reforming FDI laws and BITs in Albania and Croatia.

Chapter V will present the conclusion of the thesis: how the principles and standards that characterize the treaties and legislation regulating FDI with regard to Canada, as well as various suggestions and ideas in the political, economic and legal realms, which are described, identified and analysed in previous chapters, can help Albania and Croatia achieve their goal of economic development, increase their standard of living and facilitate their movement toward European integration.

The area of FDI is multi-disciplinary, combining economic, political, historical, cultural and legal theories and practices. The ultimate objective of this thesis is to offer a modest insight from the legal standpoint into the generally accepted principles and standards of FDI in Canada, which are based on a foundation of economic liberalism, and the way in which a model representing these characteristics will serve as a good example for the countries of Albania and Croatia.

CHAPTER II

HISTORY AND EVOLUTION OF FDI

a. What is FDI?

Today there are numerous definitions of FDI and they depend on the standpoint of the author and the relevant factors taken into account. Even though there is no accepted world-wide definition of FDI, there are similar descriptions provided by international institutions, which can be adopted for purposes of uniformity of terminology and research. UNCTAD defines FDI:

> [A]n investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate).[1]

Other international organizations, such as the WTO, the OECD, and the IMF offer similar definitions.[2] The important elements in all these definitions are those

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[1] *Supra* Chapter I, note 2 at 231. This general definition of FDI is based on OECD, *Benchmark Definition of Foreign Direct Investment*, 3rd ed. (Paris: OECD, 1996) and IMF, *Balance of Payments Manual*, 5th ed. (Washington, D.C: IMF, 1993).

[2] For complete definitions of FDI by these organizations, see World Trade Organization, Trade and Foreign Direct Investment, online: World Trade Organization <http://www.wto.org/english/news_e/pres96

components that clearly distinguish FDI from other forms of investments, such as a "long term relationship", "lasting interest and control", "two economies in two different countries (often identified as 'home country' and 'host country')", "acquiring an asset with the intent to manage that asset" and "a significant degree of influence on the management of the enterprise."[3]

The importance of having a definition of FDI (or at least of "investment") in domestic legislation is very clear when we discover that FDI receives quite different treatment than other types of investments under domestic laws and that most BITs contain a definition clause which outlines the FDI covered by the treaty.[4] The rights and responsibilities that come from adopting domestic legislation on FDI, the privileges and obligations following the signing of BITs and the standards and principles required to be fulfilled prior to investment flows all demand an exact definition of FDI. A clear and exact definition allows potential investors to be informed in advance of their opportunities and advantages of choosing one form of investment over another, which laws will be applicable to their future portfolio and which laws and regulations will govern their investments.

_e/pr057_e.htm> (accessed March 14, 2005); OECD, *Benchmark Definition of Foreign Direct Investment*, 3rd ed. (Paris: OECD, 1996) at 7-8; IMF, *Balance of Payments Manual*, 5th ed. (Washington, D.C: IMF, 1993) at 86.

[3] *Ibid.*

[4] *Supra* Chapter I, note 2 at 99.

While developed countries prefer a narrow definition of FDI, developing countries, being more willing and in greater need of revenue flows, lean toward a broader definition.[5] Canada does not provide any specific definition of FDI in its domestic legislation (neither in the IC Act, not in the Investment Canada Regulations (ICR)). However, Canada is a member state of a number of international organizations, including the WTO, OECD and United Nations (UN). Therefore, their definitions regarding FDI, though not legally binding within Canada, can be used with persuasive effect with regard to federal and provincial laws regulating the sphere of FDI.[6] Also, government reports may provide definitions of FDI with regard to policy followed by the government in relation to foreign investment.[7]

Bilateral agreements signed by Canada and other states do include broad definitions of the covered investments.[8] In particular, NAFTA, as will be discussed in the following chapter, contains the most comprehensive definition of investments,

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[5] *Ibid.*

[6] In Common Law systems, such as Canada, in contrast to civil law countries, such as most of the South East European countries, including Albania and Croatia, international agreements are not self-applicable; the federal or provincial governments must enact domestic laws, so that these international agreements may become part of the legislation of the country. Also, international organization reports are not legally binding documents.

[7] Department of International Trade, *Fifth Annual Report on Canada's State of Trade* (Ottawa, Minister of Public Works and Government Services Canada, 2004) at 43.

[8] See e.g. Canadian FIPA with Romania, Can T.S. 1997/47, Article 1(f) and Canadian FIPA with Croatia, Can T.S. 2001/4, Article 1(d).

extending its protection to almost every conceivable form of business transactions between Canada, Mexico and the US.[9]

b. History and evolution of FDI legislation in Canada, the US and the UK

FDI is a product of the historical, political and economic conditions of all societies at any given time. In order to understand better the developments of the Canadian economy and its investment trends, I will analyse its FDI history and evolution, in connection with that of the UK and US, since these two countries have had a great influence on the level and politics of FDI in Canada.

The origins of foreign investment in general may be traced to the UK in the nineteenth century, primarily as lending to enable economic development of other countries and British ownership of financial assets in these countries.[10] The UK traditionally had strong economic and political ties with Canada, one of its territories; therefore there were many British investments in Canada.[11] In contrast, British investments in the US were influenced by the open-door policy that the US had adopted since its early days as an independent country. Alexander Hamilton, first

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[9] Article 1139 of the NAFTA, see *supra* Chapter I, note 35 at 11-23.

[10] Imad A. Moosa, *Foreign Direct Investment: Theory, Evidence and Practice* (New York: Palgrave, MacMillan, 2002) at 16.

[11] Government of Canada, *Foreign Direct Investment in Canada* (Ottawa: Information Canada, 1972) at 15.

Secretary of the US Treasury and one of the earliest supporters of foreign capital investment in the US, described its potential positive effect on the domestic economy by stating that foreign capital needs to be used together with domestic capital in order to improve the use of labour and resources.[12]

British investment in Canada:

> took the form of portfolio investment concentrated in the development of communications and transportation networks. Such investment ... left no permanent stamp of foreign control on the developing economy.[13]

By 1900, Britain had invested over C$1 billion in Canada, but only C$65 million amounted to direct investments.[14] However, after WWII the majority of FDI in Canada originated from the US and by the 1980s almost two-thirds of FDI in Canada came from its southern neighbour.[15] In the US in the nineteenth century, foreign capital, mainly British, enabled the construction of railroads, factories and heavy industry.[16] Indeed European FDI was pervasive at this time:

> Britain financed US$9.25 million of the US$11.25 million bond issue for the Louisiana Purchase. By 1807 Europeans held about half of the

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[12] Edward Felsenthal, "Threat to the Republic--The Politics of Foreign Direct Investment in the United States" (1990) 14 Fletcher F. World Aff. 354 at 360.

[13] Thomas M. Franck & K. Scott Gudgeon, "Canada's Foreign Investment Control Experiment: The Law, the Context and the Practice" (1975) 50 N.Y.U. L. Rev. 76 at 85.

[14] *Ibid.*

[15] Barry M. Fisher, "Canada's Foreign Investment Review Act as a Model for Foreign Investment Regulation in the United States" (1984) 7 Can.-US L.J. 61 at 77-8.

[16] *Supra* note 12.

federal debt, and by 1845 they held half of state debts and securities and one-quarter of municipal debts and securities.[17]

Since the early flows of FDI, both Canada and the US showed a great deal of caution in trying to maintain the balance between domestic control over strategic sectors and areas of national interest, on the one hand, and encouraging the stream of foreign capital needed for development of industry, on the other. For example, during the construction of the Canadian Pacific Railway in the 1880s, American investment was strongly discouraged.[18] In 1874, Prime Minister Macdonald introduced a high tariff structure, intended to stimulate indigenous enterprise,[19] followed by the National Policy, adopted in 1878,[20] which consisted of the tariff, the railroads and immigration to the West, with the objective of economic development of the east as well as the west.[21] In the US, The Territorial Land Act[22] of 1887 "prohibited alien landholding in the organized territories, except by immigrant farmers who had applied for citizenship."[23] Similar major restrictions in American laws remained until the second half of the twentieth century.[24]

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[17] *Ibid.*

[18] I. Litvak, et al., *Dual Loyalty: Canadian-US Businesses Arrangements* (Toronto: McGraw-Hill Co. of Canada, 1971) at 117.

[19] Kari Levitt, *Silent Surrender: The Multi-National Corporation in Canada* (Toronto: Macmillan of Canada, 1970) at x.

[20] *Supra* Chapter I, note 27 at 215.

[21] *Ibid.* at 231.

[22] 48 USC. §§ 1501-07 (1976).

[23] Robert H. Mundheim & David W. Heleniak, "American Attitudes toward Foreign Direct Investment in the United States" (1979) 2 J. Comp. Corp. L. & Sec. Reg. 221 at 225.

Powerful European-based multinationals emerged during the period between 1870 and 1914, such as Lever Brothers, English Sewing Cotton and J. & P. Coats.[25] By the beginning of World War I (WWI) European direct investment abroad amounted to US$17 billion, while US outward investment stood at only US$3.5 billion.[26] WWI changed the balance of economic power completely and the alignment of countries in the realm of international investments in favour of the Americans. "By 1915, the nation was a creditor for the first time in its history."[27] At the same time, Britain's role as a world economic and financial power began to decline.[28]

Initially, US investment was attracted to Canada because of the related incentives of Commonwealth preferences, the proximity of the Canadian market and, later, by the demand for raw materials.[29] While in 1900 the US controlled only 13.6 percent of all foreign capital investment in Canada,[30] by 1926 it accounted for 53 percent[31] and by 1967 it held 80.7 percent of all foreign investment in Canada.[32] As

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[24] *Ibid.* at 226.

[25] *Supra* note 12 at 361.

[26] *Ibid.*

[27] *Ibid.*

[28] *Supra* note 10 at 16.

[29] *Supra* note 13 at 85.

[30] *Supra* note 10 at 15.

[31] *Supra* note 19 at 68.

[32] *Supra* note 13 at 85.

the above-mentioned figures show, Canada's industry was largely foreign-owned and, in particular, US-owned.

After WWI, Canada still offered to foreign investors, especially American, many appealing factors considered as prerequisites for a successful investment, such as federal and provincial incentives, cultural similarities, common language, good income levels and growth rates, political stability and physical proximity.[33] However, concern about the scale and the amount of foreign investment, especially of American origin, in Canada was renewed in the 1960's and early 1970's.[34]

This unprecedented Canadian concern over FDI was influenced by many political, economic and cultural factors and was an indicator of a change in government philosophy and policies, from economic liberalism to economic nationalism.[35] In 1972, according to one analysis, 47 percent of Canadians were expressing concern over the degree of foreign ownership in Canada.[36] In 1970, the study "Foreign Policy for Canadians" by Canada's Department of External Affairs stated that Canada's challenge was both "to live distinct from but in harmony with the

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[33] Roberto D. Gualtieri, "Canada's New Foreign Investment Policy" (1975) 10 Tex. Int'l L. J. 46 at 50.

[34] Arthur R.A. Scace, "US Investment in Canada: The Foreign Investment Review Act (FIRA) and Provincial Incentives" (1981) 4 Can.-US L.J. 100 at 100. See also William S. Barnes, "Foreign Investment in Canada and Mexico: An Agenda for Host Country Screening" (1977) 1 B. C. Int'l & Comp. L. J. 1 at 4.

[35] *Supra* note 33 at 47.

[36] *Ibid.*

world's most powerful and dynamic nation, the United States and, at the same time to maintain national unity".[37] With regard to the economic factors, in the period following 1968, unemployment levels were generally above six percent.[38] Also, US foreign politics influenced the exporting activity and the economic operation of several Canadian companies owned by US parents.[39]

The Canadian concern was not unrealistic. According to another governmental report, as of 1967:

> [A]bout 25 percent of all Canadian corporate assets are owned by foreign controlled corporations, of which about four-fifths are American controlled corporations... In some vital industries, the degree of foreign ownership is particularly high. For example: manufacturing production (60 percent); mining enterprises (60 percent); petroleum refining (99.9 percent); automobile industry (95 percent)... and the computer industry (90 percent).[40]

Canada had tried to restrict the activity of foreign companies operating in Canada even before the 1960's, but its efforts had been limited to only certain vital industrial sectors, such as mining, mineral exploration and oil and gas.[41] At this time, a series of tax incentives and disincentives were adopted as part of this economic

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[37] Department of External Affairs, *Foreign Policy for Canadians* (Ottawa: Department of External Affairs, 1970) vol. 1 at 24-25.

[38] *Supra* note 33 at 48.

[39] *Ibid.* at 47.

[40] Ian Wahn, Q.C., "Toward Canadian Identity–The Significance of Foreign Investment" (1973) 11 Osgoode Hall L. J. 517 at 530.

[41] *Supra* note 13 at 97.

nationalist policy; however, even these measures were not consistent and sometimes were affected by the outcome of political elections.[42]

In March 1966, the Canadian government issued Some Guiding Principles of Good Corporate Behaviour for Subsidiaries in Canada of Foreign Companies or the so-called "Winters' Guidelines," after the name of Trade and Commerce Minister Robert Winters.[43] One of the objectives of these Guidelines was for foreign-owned companies in Canada to develop their Canadian subsidiaries in terms of research, design and product development.[44]

These Guidelines were followed by a voluntary reporting program in order to monitor performance under these Guidelines.[45] According to Rudiak and Dewhirst this "was the first attempt by a Canadian government to influence, in a general way, the behaviour of MNEs [Multinational Enterprises] operating in Canada."[46]

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[42] For example, a magazine tax on advertising revenues of Canadian editions of foreign magazines imposed in 1957 by the Liberal Government was annulled by the new Conservative Government. *Ibid.*

[43] Gordon Dewhirst & Michael Rudiak, "From Investment Screening to Investment Development: The Impact of Canada's Foreign Investment Review Agency (FIRA) and Investment Canada in Canada's Technological Development" (1986) 11 Can.-US L.J. 149 at 150-1.

[44] *Ibid.*

[45] *Supra* note 43 at 150-1.

[46] *Ibid.*

In order to achieve this objective, the government assigned the Revenue Minister, Herb Gray, to prepare a report of findings regarding the state of foreign investment in Canada. In May 1972, the task force under the direction of Gray released its report titled Foreign Direct Investment in Canada, better known as the "Gray Report".[47] The Report officially confirmed the concern regarding the high level of foreign control over the Canadian economy, providing alarming figures in almost every area of domestic industry.[48] According to the Gray Report, "nearly sixty percent of manufacturing in Canada is foreign controlled,"[49] and "the US controls about eighty percent of Canadian manufacturing and natural resources."[50] This Report provided the basis for the introduction of the FIRA in January 1973.[51]

The Gray Report presented several alternatives of what could be done to curb the wave of investment flows to Canada and to regain a certain amount of control over Canadian industry.[52] The option preferred by the government was the establishment of a Foreign Investment Review Agency (FIRA Agency) in 1974[53]

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[47] *Supra* note 11 at 5; *supra* note 43 at 151-2.

[48] Robert A. Jaffe, "After Two Years: Canada's Foreign Investment Review Act" (1978) 3 N.C.J. Int'l L. & Com. Reg. 163 at footnote 2, at 163.

[49] *Supra* note 11 at 5.

[50] *Ibid.*

[51] *Supra* Chapter I, note 25. The FIRA entered into force in April 9, 1974. See also *supra* note 40 at 517.

[52] *Supra* Chapter I, note 27 at 214.

[53] *Supra* note 43 at 149.

which enabled the federal government to review three types of FDI in Canada: takeovers, the establishment of new businesses by non-Canadians and the expansion of business by non-Canadians in areas not related to their current economic activity.[54] FIRA's objective was to ensure that FDI provided a "significant benefit"[55] to Canada, according to a specific and detailed review procedure, in agreement with five main objectives, identified by the government as crucial for the Canadian economy namely: "beneficial effect on the Canadian economy and economic development, significant participation by Canadians, increase in technology in Canada, competitive effect on Canadian industry and that the proposed investment fit national and provincial economic policies."[56] Canada confirmed that it would continue to maintain a similar policy even after joining the OECD in 1976, as an exception to the generally accepted national treatment principle.[57]

The intention of the FIRA was not to affect existing FDI in Canada, but to find a possible way of affecting future FDI in Canada, so that it could ensure the highest benefit for the Canadian economy and not only for the foreign investor.[58] During its short time in existence (11 years), the FIRA Agency reviewed a total of

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[54] *Supra* note 33 at 46.

[55] *Supra* Chapter I, note 25 at s. 2(1). See also James M. Spence, Q.C. "Current Approaches to Foreign Investment Review in Canada" (1986) 11 Can.-U.S. L.J. 161 at 509.

[56] *Supra* Chapter I, note 25 at s. 2(2).

[57] Detlev F. Vagts, "Canada's Foreign Investment Policy: An International Perspective" (1982) 1 B.U. Int'l L. J. 27 at 30.

[58] *Supra* note 48 at 164.

6,599 investment proposals, of which almost 58 percent were in the service and construction sectors of the economy.[59] However, neither FIRA nor the activity of the FIRA Agency had a large effect on the general amount of FDI that was entering Canada, though in some areas foreign investments were reduced and kept under control.[60]

As mentioned above, the impact of the new investment review legislation and the establishment of the FIRA Agency affected FDI at a much lower level than expected. However, international investors, especially Americans (who were most alarmed about the effects of this new investment policy), expressed their concern through diplomatic and other measures, even using the dispute resolution mechanism of the GATT, which found Canada in breach of Article III: 4 of the GATT.[61] Nevertheless, Canada is not the only country that time after time has applied measures to curb the flow of investments into its territory and to control the foreign

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[59] *Supra* note 43 at 155.

[60] *Ibid.* at 154-5.

[61] The Panel established by Council of the GATT to review the dispute between the U.S and Canada with regard to the FIRA implementation issued its report, *Canada – Administration of the Foreign Investment Review Act* on February 7, 1984. It concluded that "the practice of Canada to allow certain investments subject to the Foreign Investment Review Act conditional upon written undertakings by the investors to purchase goods of Canadian origin, or goods from Canadian sources, is inconsistent with Article III: 4 of the General Agreement, according to which contracting parties shall accord to imported products treatment no less favourable than that accorded to like products of national origin in respect of all internal requirement affecting their purchase." *Canada: Administration of the Foreign Investment Review Act*, GATT Panel Report, Feb. 7, 1984, GATT 30 B.I.S.D. 140 (1984).

domination of its economy. Germany has often intervened to stop important sectors of the economy from falling into the hands of foreigners.[62] At one time, France maintained "an extensive system of controls, though rather informal ones, upon capital inflows."[63] Even the US itself, which is considered to be a country open to FDI, with its policy toward FDI referred to as "neutrality with encouragement,"[64] has contemplated taking restrictive policies, and in certain areas (communications, energy and natural resources, transportation, banking and defence) it has applied restrictive measures in the past.[65] These restrictive measures include statutes that contain numerous provisions, such as prohibition of FDI in certain areas, additional difficult or inconvenient requirements for operation of businesses, etc.[66]

The main reasons that lead to the replacement of the FIRA were the following:

> a) a change in the economic focus, which now was more concerned with the risk of bankruptcies and unemployment than with the ownership of business; b) continuing criticism from the international investment community, especially American businessmen, and; c) political changes, which resulted in the election of a government that was in favour of freer trade and closer relation with Canada's allies.[67]

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[62] *Supra* note 57 at 31.

[63] *Ibid.* at 31-32.

[64] *Supra* note 15 at 61.

[65] Brian C. Elmer & Dwight A. Johnson, "Legal Obstacles to Foreign Acquisitions of U.S. Corporations" (1974-1975) 30 Bus. Law. 681 at 698.

[66] *Supra* note 15 at 63.

[67] E. J. Arnett, "From FIRA to Investment Canada" (1985-1986) 24 Alta. L. Rev. 1 at 2-3.

The third reason, political changes, was the most important one, as the new Conservative government was more inclined to adopt economic liberal policies than its predecessor, the Trudeau Liberal government.[68] Also, changes in the structure and functioning of MNEs and recent developments in the competitiveness of the over-all technology environment affected the decision to replace the FIRA.[69] Finally, technical deficiencies in the application of the FIRA by the FIRA Agency, such as delays in the review process, vagueness of standards with regard to "significant benefits" and lack of transparency in the decision-making process of reviews,[70] pointed out the need for an updated, more procedurally fair and more efficient statute.

The IC Act was introduced in Parliament in December 1984 and entered into force on June 30, 1985.[71] Its purpose, as indicated in the law itself, was "to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada."[72] The IC Act established a new agency, Investment Canada, which was responsible for the review of the investment, though in a more limited fashion than

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[68]As I will discuss below, these liberal policies were evident in the enactment of IC Act in 1985.

[69] *Supra* note 43 at 150, 158.

[70] Spence, *supra* note 55 at 514-516.

[71] *Supra* Chapter I, note 34. See also W. Brian Rose, "Foreign Investment in Canada: The New Investment Canada Act" (1986) 20 Int'l L. 19 at 20.

[72] *Ibid.* Chapter I, note 34.

the previous FIRA Agency,[73] with the IC Act coverage limited only to "significant investment." The main mandate of Investment Canada was to encourage and facilitate investments.[74] While the FIRA's character was more defensive and protective of the Canadian economy, demonstrating a policy of economic nationalism, the IC Act is more open and encouraging of foreign investment in Canada. It adopts an approach more reflective of economic liberalism, although maintaining some nationalist traits. While the FIRA recognized concern about FDI in Canada, the IC Act underlines the benefits and the contribution of FDI to the economy in general.[75] It has been maintained to the present by successive Liberal governments.

In contrast stands the treatment of FDI by the US government. After WWII, the amount of FDI in the world began to grow, for two main reasons: (1) technological improvements in transportation and communication that allowed the distant control of a corporation located in another country or even another continent and (2) the rebuilding of infrastructure and economies in general of countries destroyed or affected by the war.[76] This period of time marked the beginning of expansion of US FDI[77] (the US suffered relatively small damage to its territory and strategic interests abroad during WWII), which then moved into West Europe and

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[73] *Supra* note 43 at 159.

[74] *Ibid.*

[75] *Ibid.*

[76] *Supra* note 10 at 16-17.

[77] *Ibid.*

Japan in response to their needs for reconstruction. This same time period also signalled that British influence as the world leader in FDI had begun to fade away, only to stage somewhat of a comeback in the late 1970s as I will discuss below.[78]

The US generally has maintained an open door policy with regard to FDI – albeit with certain limited restrictions as discussed above[79] – regardless of whether inward or outward FDI was involved, based on the principle of non-intervention on the part of the government and the application of the national treatment principle granted to all investors.[80] As mentioned earlier, Americans have been the largest investors in Canada for a long period of time and they have also invested extensively in Europe since the nineteenth century.[81] However, the amount of inward FDI in the US was relatively limited until the early 1970s – for almost two centuries, from 1789 to 1970, FDI in the US amounted to only US$13 billion)[82] – so there was not much domestic opposition voiced toward FDI. However, in only a period of twelve years, from 1970 to 1982, inward FDI in the US reached the amount of US$86 billion,[83] due mainly to a drive to access US technology.[84] Other reasons for the FDI boom at this

[78] *Ibid.* For further discussion of Britain's comeback to the FDI scene see *infra* text accompanying notes 112 to 119.

[79] *Supra* note 65 at 62-63.

[80] *Supra* note 23 at 221.

[81] *Infra* note 105 at 397.

[82] *Supra* note 15 at 67.

[83] *Ibid.*

[84] *Ibid.*

time included the revival of the economies of Europe and Japan after WWII, the absence of internal barriers to trade among the American states when compared to nations in Europe, the economically and politically stable environment and the very limited restrictions on the establishment of foreign enterprises in the US.[85] The largest foreign investors in the US during this time were the UK (US$32.5 billion in 1983), followed by the Netherlands, Japan, West Germany and Switzerland.[86] The record level of FDI was in 1978, with US$6.3 billion.[87] The increased inward FDI in the US created a considerable amount of concern from domestic investors and the public.[88]

While some reports from various US government agencies advocated the establishment of review mechanisms (similar to the FIRA adopted earlier in Canada), by listing all the dangers and economic and political costs of FDI,[89] other reports opposed this idea, arguing that there was no need "at this time" for such action, since FDI was not a significant factor in the US economy and that several methods to monitor and control the flow of FDI were already in place.[90] Several bills were introduced in Congress, aiming to restrict, limit or curb the tide of FDI in the US;

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[85] Harvey E. Bale, Jr., "United States Policy toward Inward Foreign Direct Investment" (1985) 18 Vand. J. Transnat'l L. 199 at 205-206.

[86] *Ibid.* at 204.

[87] *Supra* note 23 at 223.

[88] *Ibid.*

[89] *Supra* note 15 at 86.

[90] *Ibid.* at 87.

however, they were always rejected by the administration and, consequently, were not adopted.[91] The US policy toward FDI remained unchanged, regardless of the considerable increase in the amount of inward FDI, with the restrictive provisions in several laws and regulations still in place, as mentioned above.[92]

The major restriction to FDI in the US was introduced in 1989 with the adoption of the Exon-Florio amendment to the Defence Production Act,[93] which gives the US President the authority to restrict foreign investment when these investments might have a negative effect on US national security.[94] The US government, prior to the adoption of this amendment, only monitored the flow of foreign capital into its economy,[95] as provided in the International Investment and Trade in Services Survey Act of 1976,[96] and overseen by the Committee on Foreign Investment in the United States (CFIUS), established under the Ford Administration in 1975.[97] However, as

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[91] *Supra* note 23 at 222.

[92] *Ibid.*

[93] Defense Production Act of 1950, 50 U.S.C.S. App. § 2152 et seq. (1982).

[94] The Exon-Florio amendment, (named after its authors) is appropriately entitled "Authority to Review Certain Mergers, Acquisitions, and Takeovers." This act amends Title VII of the *Defence Production Act*, and constitutes Section 5021 of the *Omnibus Trade and Competitiveness Act* (Omnibus Trade and Competitiveness Act of 1988, Pub. L. No 100-418. § 5021, 102 Stat. 1107, 1425 (1988). See L. T. Boehringer, "The Exon-Florio Amendment: An Imperative Restraint on Foreign Direct Investment in the United States" (1900-1991) 9 Int'l L.J. 413 at 421.

[95] *Ibid.* at 421.

[96] International Investment and Trade in Services Survey Act of 1976, 22 U.S.C. § 3101 (1988).

[97] Boehringer, *supra* note 94 at 428.

Lash eloquently described it "...CFIUS remained a relatively sleepy watchdog, barking occasionally at a few intruders, but scaring no one."[98]

Some authors have expressed concern that the Exon-Florio amendment has the potential for abuse, especially since it does not define specifically "national security," allowing for countless ways of interpreting this term.[99] The Byrd-Exon Amendment[100] that followed in 1992, amending the Exon-Florio, did not address this concern.[101] Instead, it made the process of review of FDI by the CFIUS and the President even more complex,[102] by expanding the scope of the application of Exon-Florio.[103] After the terrorist attacks on September 11, 2001, the attention of the US government and its institutions overseeing FDI seems to have been shifted to focus on the individual or the multinational company interested in the takeover, acquisition or merger of a specific US-based enterprise, rather than in its nationality and origin of capital.[104] Today, the real threat to democracy, economic stability and safety is

[98] William H. Lash III, "The Buck Stops Here: The Assault on Foreign Direct Investment in the United States" (1991-1992) 36 St. Louis U. L.J. 83 at 89.

[99] *Ibid.* at 104.

[100] National Defense Authorization Act for Fiscal Year 1993, Pub. L. No. 102-484, § 837, 106 Stat. 2463 (1992)

[101] Patrick L. Schmidt, "The Exon-Florio Statute: How it Affects Foreign Investors and Lenders in the United States" (1993) 27 Int'l L. 795 at 796.

[102] Christopher R. Fenton, "US Policy Toward Foreign Direct Investment Post-September 11: Exon-Florio in the Age of Transnational Security " (2002) 41 Colum. J. Transnat'l L. 195 at 207-208.

[103] *Supra* note 101 at 796.

[104] *Supra* note 102 at 200.

presented by non-state actors; therefore the trend in the US is to take these factors into account when considering their relationship to FDI.

In Britain, the first recorded cases of FDI date from the 1850s, with almost 50 percent of the companies being from the US and the majority of the other half from Germany.[105] At this time, most of the foreign investors in Britain targeted the consumer market; however, from 1890 this focus shifted toward the industrial sector.[106] However, even at this early time many British companies had extended their investments in numerous countries, such as J. & P. Coats, which by 1914 had "fifty-three operations in fifteen countries,"[107] and its first investment in the US in 1869.[108] At this time, British investments extended into more countries compared to US or other state investments.[109] This was in addition to the traditional form of British investment in the US, Canada and other countries, i.e. portfolio investment, as mentioned above.[110]

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[105] Andrew C. Godley, "Pioneering Foreign Direct Investment in British Manufacturing" (1999) 73 Bus. His. Rev. 394 at 397.

[106] *Ibid.* at 394.

[107] Dong-Woon Kim, "J. & P. Coats as a Multinational Before 1914" (1997) 26 Bus. and Eco. His. 526 at 526.

[108] *Ibid.* at 528.

[109] *Ibid.*

[110] *Supra* note 13 at 66.

After WWII, as mentioned earlier, British supremacy in the field of FDI slowly began to disappear.[111] In the 1970s, the economic situation in the UK was alarming: the sterling had experienced a currency crisis; inflation had risen to above 20 percent and the unemployment rate reached record levels of one million during 1970-1974.[112] The Labour Government established the Invest in Britain Bureau (IBB) in 1977, with the objective of creating new sources of employment,[113] and its mandate included the goal of increasing the amount of new investments in the UK and expanding the resources from which these investments were expected.[114]

The creation of the IBB (today UK Trade & Investment) was followed by a series of legislative acts and policies (reform of trade unions, deregulation and privatization of state-run industries, taxes and public expenditures) whose implementation allowed the UK to overcome its economic crisis and set it apart from other European competitors.[115] In the 1990s, inward investments in the UK mainly came from the US, which accounted for 45 percent of the total inward investments, followed by European Community (EC) countries, which amounted to 15 percent of

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[111] *Supra* note 10 at 16-17.

[112] Andrew Fraser, *Case Study: Inward Investment in the UK* (London: UK Trade and Investment, 1999) at 3-4.

[113] *Ibid.* at 4.

[114] *Ibid.* at 5.

[115] *Ibid.* at 10.

total inward investments.[116] These investments are mainly concentrated in the energy sector of the UK economy.[117] According to UK Trade & Investment figures, today "[i]n terms of inward investment, the UK remains the world's No. 2 location (after the US) for stocks of FDI",[118] and is the "number one location in Europe in terms of attracting foreign investment in 2003."[119] The World Investment Report 2004 ranks the UK as the fourth country in the world for outward FDI;[120] however inward investments in the UK fell almost by half in 2003.[121] The OECD has found that the UK has the fewest restrictions regarding inward investments among OECD countries,[122] where there are no screening requirements for foreign investments and very few restrictions on foreign ownership, foreign personnel and operational freedom.[123] However, Industry Canada notes that "foreign (non-EU or non-EFTA [European Free Trade Association] ownership of UK airlines is limited by law to 49

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[116] Peter J. Buckley, et al., *Canada-UK bilateral trade and investment relations* (London: MacMillian Press, 1995) at 44.

[117] *Ibid.*at 49.

[118] UK Trade and Investment, *Investment Bulletin*, 3rd ed. (London: UK Trade and Investment, 2004) at 1.

[119] *Ibid.* at 1.

[120] UNCTAD, *World Investment Report 2004: The Shift Toward Services* (New York and Geneva: United Nations, 2004) at xx.

[121] OECD, *Trends and Recent Developments in Foreign Direct Investment* (Paris: OECD, 2004)

[122] OECD, *Foreign Direct Investment Restrictions in OECD Countries* (Paris: OECD, 2003) at 5.

[123] OECD, *Measures of Restriction on Inward Foreign Direct Investment for OECD Countries* (Paris: OECD, 2003) at 104.

percent,"[124] certain mergers and takeovers in protected sectors, such as air and maritime transport, fishing and defence, require governmental approval,[125] and activities related to investments in the financial sector require either government authorization or exemption.[126]

c. The contemporary importance of FDI

FDI is a crucial element both in global trade and the domestic economies of specific countries. Statistics from international organizations for regional trade performance,[127] as well as governmental reports on economic development and growth,[128] confirm that FDI plays an indispensable role in the growth of an economy.

The view of international institutions is to consider FDI as a tremendously important sign of the growth in international trade and in economic development and stability.[129] Today there are a variety of bodies and fora to assist in the analysis of

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[124] Industry Canada, United Kingdom Country Commercial Guide FY 2003 - Investment Climate Statement, online: Industry Canada <http://strategis.ic.gc.ca/epic/internet/inimr-ri.nsf/en/gr107258e.html> (accessed March 14, 2005).

[125] *Ibid.* For specific provisions on government approval for mergers, acquisitions and takeovers see Enterprise Act 2002 (U.K.) 2002, c. 40, s. 22 and Competition Act 1998 (U.K.) 1998, c. 41, sch.1.

[126] See Financial Services and Markets Act 2000 (U.K.) 2000, c. 8, s. 31, s. 32.

[127] For an example of international organizations' reports on regional trade performance see *infra* note 136.

[128] *Supra* note 7 at 1, 43.

[129] *Supra* Chapter I, note 2 at iii.

and relationship between these indicators. UNCTAD considers FDI as "a vital factor in the long-term economic development of the world's developing countries,"[130] stressing its "enormous potential to create jobs, raise productivity, enhance exports and transfer technology."[131] The WTO's position is that investments are closely linked to trade, given the fact that "about one third of the US$6.1 trillion total for world trade in goods and services in 1995 was trade within companies."[132] It recognizes the importance of FDI in the development of the economy of a country and, to that effect, since 1996 the WTO has created two working groups assigned specifically with the task of examining how trade relates to investment and competition policies.[133] The Doha Round of WTO negotiations, which began in Qatar in November 2001 included in the agenda, among other issues, the relationship between trade and investment and the interaction between trade and competition policy.[134] However, given the reluctance of developing state members to negotiate liberalization in this sector, the General Council of the WTO decided on August 1, 2004 that the relationship between trade and investment will not form part of the Work Program any longer.[135]

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[130] *Ibid.*

[131] *Ibid.*

[132] *Supra* Chapter I, note 1.

[133] *Ibid.*

[134] World Trade Organization, *The Doha Texts* (Geneva: World Trade Organization, 2001)

[135] World Trade Organization: Doha Development Agenda: Doha Work Programme, online: World Trade Organization <http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm> (accessed March 14, 2005).

The WB states that FDI "is a telling indicator of global economic health and stability," by pointing to a direct connection between the economic well-being of a region and the dimensions of FDI in that region.[136] The International Center for Settlement of Investment Disputes (ICSID)[137] was established in 1966 in order to "facilitate the settlement of investment disputes between governments and foreign investors," pursuant to the ICSID Convention,[138] which would "help to promote increased flows of international investment."[139] The Multilateral Investment Guarantee Agency (MIGA),[140] another institution created in 1985, aims to "promote foreign direct investment into emerging economies to improve people's lives and reduce poverty."[141] MIGA strives to achieve this objective by "offering political risk insurance (guarantees) to investors and lenders and by helping developing countries attract and retain private investment."[142]

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136 World Bank, *Foreign Direct Investment Survey* (Washington, D.C.: World Bank, 2002) at 9.

137 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 159.

138 International Center for Settlement of Investment Disputes: About ICSID, online: International Center for Settlement of Investment Disputes <http://www.worldbank.org/icsid/about/about.htm> (accessed March 14, 2005).

139 *Ibid.*

140 Convention Establishing the Multilateral Investment Guarantee Agency, Oct. 11, 1985, 1508 U.N.T.S. 181.

141 Multilateral Investment Guarantee Agency: About MIGA, online: Multilateral Investment Guarantee Agency <http://www.miga.org/screens/about/about.htm> (accessed March 14, 2005).

142 *Ibid.*

For the most part, Canada (with the exception of its early years and the FIRA decade) and the US have overall maintained an economic liberal point of view toward FDI and its role in the economy since their foundation as independent countries.[143] With the adoption of the IC Act, Canada, in the words of its then Prime Minister Mulroney "is open for business again,"[144] while the Exon-Florio amendment, the major restriction on FDI in the US, is limited to "national security" matters.[145] In recent years, Canada and the US have signed two extremely important free trade agreements, the CUFTA, which entered into force on January 1, 1989 and the NAFTA, in force on January 1, 1994.[146] These two agreements, analysed in the following chapter, provide for free trade in goods and services among the three countries, a more liberal regime for investments and elimination or reduction of non-tariff trade barriers. Their results are already visible.[147] Today, the US imports more oil from Canada than from any other country.[148] The Canada-US trade relationship is the largest in the world, with US$1.9 billion of goods and services crossing the Canada-US border every day.[149]

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[143] *Supra* text accompanying notes 71 to 79.

[144] *Supra* note 67 at 2-3.

[145] Boehringer, *supra* note 94 at 428.

[146] *Supra* Chapter I, note 35. See also Alan M. Rugman, ed., *Foreign Investment and NAFTA* (Columbia: University of South Carolina Press, 1994) at 156.

[147] *Supra* Chapter I, note 38.

[148] *Ibid.*

[149] *Ibid.*

d. Overview of Canadian domestic legislation related to FDI

In general, FDI in Canada has been continuously on the increase. UNCTAD ranks Canada as the eighth country in the world with respect to the total amount of inward FDI flows and the sixth country in the world regarding the total amount of outward FDI flows.[150] The operation of Canadian companies in attracting FDI has been impressive: "Since 1994, foreign direct investment in Canada grew by 131 per cent to US$357.5 billion at the end of 2003."[151] Most of this FDI comes from the US. In 2003, the US accounted for 63.9 percent of all FDI in Canada, the EU came second with 27.1 percent, followed by Asia/Oceania with only 5.1 percent.[152] The UK was second among the European investors, with only US$27.1 billion FDI in Canada or less than one-tenth of the amount invested by US companies, which was $228.4 billion.[153]

The Canadian economy continues to be closely interconnected with the economy of the US. In 2002, roughly 90 percent of Canadian merchandise exports went to the US, a 17 percent increase from 1988, while Canadian imports from the

[150] *Supra* Chapter I, note 2 at 70.

[151] The World Invests in Canada: Total Foreign Direct Investment in Canada, 1994 - 2003, in billions (Cdn), online: Ontario <http://www.2ontario.com/welcome/coca_201.asp> (accessed March 14, 2005).

[152] *Supra* note 7 at 45.

[153] *Ibid.*

US remained at the unchanged level of 65 percent of total imports.[154] In 2001, Canada exported about 31 percent of its energy production (Canada is the fifth-largest energy producer in the world)[155] to the US and in the first three-quarters of 2003 was the largest exporter of oil to the US.[156] The US still maintains a significant FDI share in Canadian oil field assets and even more mergers and acquisitions took place during the last few years,[157] followed at a much lower level of investment from the UK and several other EU countries.[158] Currently, more than 50 percent of FDI in every industrial sector of Canada comes from the US.[159]

Today, the IC Act is the foremost piece of legislation that governs foreign investments in Canada (being amended insignificantly during its years in existence) and is supported by a series of regulations, guidelines and interpretation notes issued by the Minister of Industry, Science and Technology.[160] Other specific statutes and regulations govern areas of trade and commerce that are related to or affected by FDI,

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[154] IMF, *Country Report No. 04/60 – Canada: Selected Issues at 73* (Washington, D.C.: International Monetary Fund, 2004) at 73.

[155] Canada Country Analysis Brief, online: Energy Information Administration <http://www.eia.doe.gov/emeu/cabs/canada.html> (accessed March 14, 2005).

[156] *Ibid.*

[157] E.g. ConocoPhillip purchased Gulf Canada for US $ 8.9 billion and Devon Energy carried out the acquisition of Anderson Exploration for US $ 7.1 billion in 2001. See *supra* note 155.

[158] Trade Negotiations and Agreements, online: Department of Foreign Affairs and International Trade <http://www.dfait-maeci.gc.ca/tna-nac/doorsworld/03-en.asp> (accessed March 14, 2005).

[159] *Supra* note 7 at 46.

[160] The main regulations are Investment Canada Regulations SOR/85-611.

such as the NAFTA Implementation Act,[161] Bank Act,[162] Canada-United States Free Trade Agreement Implementation Act,[163] Canada Corporations Act,[164] and Canada Business Corporations Act.[165] Foreign investment in the financial sector is administered by the federal Department of Finance and The Broadcasting Act[166] governs foreign investment in radio and television broadcasting.[167]

e. Main Canadian FIPAs and FTAs

Besides the CUFTA and the NAFTA, Canada has entered into more than 26 FIPAs since 1989, mostly with countries of Central and East Europe and Latin America, such as Poland,[168] Hungary,[169] Croatia,[170] Romania,[171] Panama,[172] Venezuela[173] and El Salvador.[174] Canada has also concluded Free Trade Agreements

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[161] S.C. 1993, c. 44.

[162] S.C. 1991, c. 46.

[163] S.C. 1988, c. 65.

[164] R.S.C. 1970, c. C.-32.

[165] R.S.C. 1985, c. C-44.

[166] S.C. 1991, c. 11

[167] *Supra* Chapter 1, note 6 at 60.

[168] Can T.S. 1990/43.

[169] Can T.S. 1993/14.

[170] Can T.S. 2001/4.

[171] Can T.S. 1997/47.

[172] Can T.S. 1998/35.

[173] Can T.S. 1998/20.

(FTAs) with Israel,[175] Chile,[176] and Costa Rica.[177] Currently Canada is negotiating FTAs with four countries of Central America: El Salvador, Guatemala, Honduras and Nicaragua, the so-called Central America Four;[178] the EFTA countries (Iceland, Norway, Switzerland and Liechtenstein)[179] and the Free Trade Area of the Americas (FTAA).[180] FTAs with the Caribbean Community (CARICOM) and Andean Community (composed of Bolivia, Colombia, Ecuador, Peru and Venezuela) are also under negotiation.[181] NAFTA Chapter 11 has influenced the text of those FIPAs and FTAs that were signed after NAFTA entered into force in January 1994.[182] FIPAs are "designed to protect and promote foreign investment through legally-binding rights

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[174] Signed May 31/99, but not yet in force.

[175] Can T.S. 1997/49.

[176] Can T.S. 1997/50.

[177] Can T.S. 2001/10.

[178] Regional and Bilateral Initiatives, Canada - Central America Four Free Trade Agreement Negotiations, online: International Trade Canada <http://www.dfait-maeci.gc.ca/tna-nac/ca4-en.asp> (accessed March 14, 2005).

[179] Regional and Bilateral Initiatives, Canada - European Free Trade Association (EFTA), online: International Trade Canada <http://www.dfait-maeci.gc.ca/tna-nac/efta-en.asp> (accessed March 14, 2005).

[180] Free Trade Area of the Americas (FTAA), online: International Trade Canada <http://www.dfait-maeci.gc.ca/tna-nac/ftaa1-en.asp> (accessed March 14, 2005).

[181] *Ibid.*

[182] Trade Negotiations and Agreements: Listing of Canada's Existing FIPAs, online: Department of Foreign Affairs and International Trade <http://www.dfait-maeci.gc.ca/tna-nac/fipa_list-en.asp> (accessed March 14, 2005).

and obligations,"[183] and contain many standards and principles for the bilateral treatment of investments. FIPAs will be discussed in detail in Chapter III.

Finally, Canada is an active member of UNCTAD, the OECD, the IMF, the WTO and other international institutions. Even though the main focus of these organizations is not FDI, but rather is global regulation of trade and economic developments in its members, because of the interdependency of FDI and sustainable economic development and growth, as noted above,[184] decisions made by these international bodies affect FDI on a country, regional and global level.

f. Conclusions

Even though there is no single globally accepted definition of FDI, the majority of state governments currently agree that FDI is a very important ingredient of the recipe for a profitable economy and a successful state. Developed countries have paid special attention to FDI since the initial stages of their existence and have used their legislation in order to support and encourage inward FDI at times and to restrict and limit these flows at other times. Economic, historical and political relationships and circumstances, which play a decisive role in the development of FDI and its governing legislation, should be taken into consideration when making crucial decisions about the economic future of certain areas of the economy.

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[183] *Supra* note 158.

[184] See *supra* Chapter I, note 2 at 1.

The existence of legislation that excludes certain areas of the economy from foreign investors and/or establishes a specific reviewing agency is considered effective as long as these measures do not cause more harm than good by becoming obstacles to the development of the economy or to the encouragement of the very investment they were suppose to assess. Economic nationalism should not become an obstacle to economic development and growth of a nation, but instead should protect only newly-created industries and essential domestic products or sectors. As noted above, changes in economic policies can bring tremendous impacts on the economy and the standard of living of the people. Therefore, these policies should be formulated based on comprehensive discussions and debates and not as the outcome of impulsive decisions or rewards for political support.

In the following chapter, I will focus on the IC Act and some of the most relevant FIPAs that Canada has signed with the countries of Central and East Europe. I will also analyse the CUFTA and Chapter 11 of NAFTA, with regard to their effect on FDI. From these analyses and discussions I will present several principles and standards that are the typical features of these agreements that constitute the Canadian model of FDI legislation.

CHAPTER III

CANADIAN DOMESTIC LEGISLATION AND BITS: PRINCIPLES AND STANDARDS

a. Domestic legislation affecting FDI levels

1. Legislation on FDI: The IC Act

Developed states, such as Canada, whose economies are based on economic liberalism, still maintain domestic legislation regulating inflows of FDI. In this section I am going to focus on three examples of areas regulated by Canadian domestic statutes: FDI in general, which is regulated by the IC Act, financial institutions, which are mainly governed by the Bank Act and, broadcasting and cultural industries, regulated by an array of statutes such as the Broadcasting Act,[1] the Copyright Act,[2] the Patent Act,[3] and the Trade-Marks Act.[4]

[1] *Supra* Chapter II, note 166.

[2] R.S.C. 1985, c. C-42.

[3] R.S.C. 1985, c. P-4.

[4] R.S.C. 1985, c. T-13.

As mentioned in Chapter II,[5] the IC Act is the main law that governs investments in Canada, while other statutes and regulations exist in order to regulate specific areas of trade and commerce influenced by the FDI. This section will focus on the main provisions and standards of the IC Act and some of the regulations contemplated by these additional statutes.

The IC Act recognises that its purpose is to "encourage investment in Canada by Canadians and non-Canadians."[6] It is important to note that even though the Act assigns the duty of the administration of this Act to the Minister,[7] assisted by the Director of Investments,[8] it also provides for cooperation of the Minister with various governmental departments, branches and agencies as well as private entities where it is appropriate for the implementation of the Act.[9] The definition of "assets" is also an important feature of the Act, as it provides protection for both tangible and intangible properties of any value.[10] Since the importance of intangible properties (such as software and intellectual property (IP)) has increased tremendously during recent

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[5] *Supra* Chapter II, note 160.

[6] *Supra* Chapter I, note 34 at s. 2.

[7] *Ibid.* at s. 4. The Minister designated for the administration of the IC Act is the Minister of Industry, Science and Technology. See SI/90-28.

[8] *Ibid.* at s. 6.

[9] *Ibid.* at s. 5.

[10] *Ibid.* at s. 3.

years,[11] this is a crucial provision, addressing the concerns of both domestic and foreign investors.[12]

The IC Act reflects the economic liberal attitude of the Canadian government by encouraging and facilitating FDI in Canada. The threshold for foreign investors from WTO countries guarantees very few investment reviews and it has been increased every year.[13] The IC Act is also noteworthy because it provides for notification and review procedures in certain cases when foreign investors wish to invest in Canada.[14] This review procedure is straightforward and deals with only those investments that seek to acquire control of a Canadian business, when the value of the transaction is C$5 million or more for foreign investors from non-WTO countries.[15] Establishment of new business in Canada is generally exempt from the

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[11] John E. Wick, Jr., "Intellectual Property Aspects of NAFTA and GATT: An Update" (1993-1994) 2 Tex. Intell. Prop. L. J. 131 at 144.

[12] Joseph S. Papovich, "NAFTA's Provisions Regarding Intellectual Property--Are They Working as Intended--A U.S. Perspective" (1997) 23 Can.-U.S. L. J. 253 at 255; G. Bruce Doern & Markus Sharaput, *Canadian Intellectual Property: The Politics of Innovating Institutions and Interests* (Toronto: University of Toronto Press, 2000) at 8.

[13] The Minister, in exercising the duties assigned by the IC Act, s. 14.1(2), has increased the threshold amount from C $ 172 million in 1997 to an expected C $ 250 million in 2005. Industry Canada, Investment Canada Act – Thresholds, online: Industry Canada <http://strategis.ic.gc.ca/epic/internet/inica-lic.nsf/en/h_lk00050e.html> (accessed March 14, 2005).

[14] *Supra* Chapter I, note 34 at s. 11 and s. 14.

[15] *Ibid.* at s. 14(1), s. 14(3).

review procedure and subject only to notification of the Director of Investments,[16] but a review procedure may be ordered by the Governor in Council if the new business activity is related to Canada's cultural heritage or national identity or such a review is in the public interest.[17] In cases of FDI in the areas of production of uranium, the provision of financial services or transportation services, and cultural businesses, the review procedure is obligatory based on a much lower threshold of invested capital.[18] The IC Act also provides for an independent process of appeal in cases where the investor fails to comply with the requirements of the IC Act, for example failure to give notice of investment or when the investor implemented an investment the implementation of which is prohibited by the IC Act.[19]

Regardless of the factors taken into account in reviewing an investment, it is important for these factors to be known, precise and unambiguous so that the review agency has a clear operating mandate and the foreign investors are given correct and clear advance notice of the prerequisites they must satisfy. In addition, the factors should not be too numerous or complicated otherwise they will dissuade foreign investors from going through a long review process. Transparent and expedient procedures of review are also vital in the process of assessing the admissibility of a foreign investment.

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[16] *Ibid.* at s. 11(a), s. 12.

[17] *Ibid.* at s. 15.

[18] *Ibid.* at s. 14.1(5).

[19] *Ibid.* at s. 40 (5). See also s. 39.

Each country has certain strategic industries or interests for which it provides extra protection and in which FDI is either limited or prohibited, as I will discuss below.[20] Therefore, in those cases when countries consider certain industries or aspects of a particular industry to be of special economic, political or cultural importance for them, they should provide extra protection for these industries in the legislation and set rules for the limitation or prohibition of FDI in these sectors. I will present some examples of such laws in the Canadian context in the following paragraphs.[21]

2. Financial institutions: The Bank Act

While the Bank Act[22] does not itself provide for limits on FDI in the banking sector, the activity of foreign investors in this important sector of the Canadian economy is regulated by the IC Act. The threshold for FDI in the financial sector, including banking institutions, is C$5 million regardless of whether foreign investors are from a WTO or a non-WTO country.[23] This amount is considerably much lower than in other sectors of the Canadian economy where the general threshold for foreign investors from WTO countries in 2005 is expected to be C$250 million in 2005.[24]

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[20] See *infra* text accompanying notes 106 to 110.

[21] See *infra* text accompanying notes 40 to 42.

[22] *Supra* Chapter II, note 162.

[23] *Supra* Chapter I, note 34 at s. 15.

[24] See *supra* note 13.

The Bank Act, in turn, specifies that no bank can commence its operations in Canada unless it controls a paid-in capital of C$5 million or any greater amount.[25]

The Bank Act also provides the definition of "substantial investment" in a banking institution, stating that a substantial investment takes place when a person or an entity controls more than "10 percent of the voting rights"[26] in a banking institution. In many developed countries, a 10 percent investment is considered to be the threshold of FDI.[27] We can see the parallel of using the same measuring standard for both FDI in general and foreign investment in banking activities, since both of these activities are extremely important for the development of the economy of any given country.

The banking sector also plays a role in the overall environment which can encourage or discourage FDI. Banks in general and commercial banks in particular, in their role as the "middleman in financial services,"[28] have offered since the 1920s

[25] *Supra* Chapter II, note 162 at s. 46(1) and 52(1).

[26] *Ibid.* at s. 10.

[27] See *OECD Benchmark Definition of Foreign Direct Investment*, 3rd ed., supra note 1 at §8, Chapter 1 and *Balance of Payments Manual of IMF*, 5th ed., supra note 1 at §362, Chapter 1. According to IMF, almost all OECD countries use the criterion of percentage as the basic indicator for identifying direct investments in their economies. See IMF, *Foreign Direct Investment Statistics: How Countries Measure FDI*, 2001 ed. (Washington, D.C: IMF, 2001) at 24.

[28] Neil McCarthy, "M&A in the Banking Industry: Investment Banking Perspective" (1996) 1 Fordham Fin. Sec. Tax L. F. 17 at 18.

various types of banking activities, such as credit lines, commercial loans and security certificates, that directly support the operation of business companies with regard to their future investments.[29] In some cases, investment counselling may constitute an important part of the business activity of certain financial institutions,[30] while investment banks have proven to be crucial institutions in the operation of small or large companies, as well as managing individual funds.[31] Finally, a trustworthy and stable banking system has indispensable effects on the encouragement of FDI in the country.[32]

Both Canada and the US provide for financial safeguards in the event of a bank failure. In Canada, the Canada Deposit Insurance Corporation Act[33] guarantees deposits in Canadian financial institutions up to C$60,000.[34] The Canadian

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[29] Almarin Phillips, "The Metamorphosis of Markets: Commercial and Investment Banking" (1978) 1 J. Comp. Corp. L. & Sec. Reg. 227 at 229.

[30] *Supra* Chapter II, note 162 at s. 409. In addition, Part IX of the *Bank Act*, starting with Section 464 is completely dedicated to rules for banks in their activity related to investments, whether they are financing investments of other companies in the form of loans or are acquiring an entity that operates in another sphere of the industry.

[31] Robert M. Kurucza & Natalie H. Diana, "Securities and Investment Activities of Banks" (1994-1995) 50 Bus. Law. 1109 at 1109. Also see David M. Eaton, "The Commercial Banking-Related Activities of Investment Banks and Other Non-Banks" (1995) 44 Emory L. J. 1187 at 1205 and 1213.

[32] Sinisa Kusic & Vladimir Cvijanovic "The Importance of Foreign Direct Investments for Stimulating Economic Growth in Croatia" *Osteuropa-Wirtschaftv (2003)* 48:1, 64 at 82.

[33] R.S.C. 1985, c. C-3.

[34] *Ibid.* s. 12(c).

government in its budget for 2005 has made the commitment to increase the deposit insurance coverage to C$100,000.[35] In the US, the Federal Deposit Insurance Act[36] guarantees deposits in US financial institutions up to US$100,000.[37]

In the next chapter I will argue that, at this time, in Albania and Croatia, the level of trust in banking institutions is very low, the majority of transactions are conducted in cash, the use of credit cards is quite limited and most of the currency flows outside banking channels.[38] However, foreign investors require stable and secure banking structures in order to enable the transfer of their capital to the host country and, later, to facilitate the transfer of the expected profit back to the home country. Banking policy should be the crux of every sound monetary policy, in connection with a stable currency exchange rate, a controlled rate of inflation and a low trade deficit.[39]

3. Cultural industries and IP legislation

Cultural industries, considered to have a paramount importance by the Canadian government in terms of maintaining Canadian identity and sovereignty,

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[35] Department of Finance, Budget 2005 – Overview, online: Department of Finance <http://www.fin.gc.ca/budget05/pamph/paovee.htm> (accessed March 14, 2005).

[36] Federal Deposit Insurance Act, 12 U.S.C. Sec. 1811 (1950).

[37] *Ibid.* s. 11.

[38] See *infra* Chapter IV, text accompanying notes 115 to 117 and 176 to 184.

[39] See *infra* Chapter VI, text accompanying notes 217 to 218.

especially given the close location of powerful US communications and media companies, are especially protected by the Canadian domestic legislation. The Broadcasting Act, despite the fact that it does not expressly mention the conditions of FDI in the area of broadcasting, declares that the "Canadian broadcasting system shall be effectively owned and controlled by Canadians,"[40] in order to "safeguard, enrich and strengthen the cultural, political, social and economic fabric of Canada."[41] The IC Act also provides for special treatment of FDI when it is related to Canadian cultural heritage or national identity.[42] NAFTA, (for example Annex 2106, Cultural Industries), as discussed below, also provides exceptional protection for Canadian cultural industries. In addition, the Copyright Act, the Patent Act and the Trade-Marks Act are some of the other pieces of legislation that regulate Canadian cultural, industrial and trademark properties and rights. Canada is also a contracting party to the main international treaties on protection of IP.[43]

4. Importance of the domestic legal system for attracting FDI

I would like to underline once more the importance of having sound domestic laws in place in order to encourage FDI. BITs, regional treaties and multilateral agreements mean nothing if they are not supported by relevant domestic laws and

[40] *Supra* Chapter II, note 166 at s. 3(1)(a).

[41] *Ibid.* at s. 3(1)(i).

[42] *Supra* Chapter I, note 34 at s. 15.

[43] Canada became a contracting party to the Berne Convention in 1928; the Paris Convention in 1925 and the WTO TRIPs agreement in 1994.

regulations which uphold the principles prescribed in the international agreements and provide domestic institutions with the means and the monetary resources for the encouragement and protection of FDI.[44] Besides economic advantages and natural resources that attract a foreign investor to a host country, "there is strong evidence, that legal and administrative structures can also influence the nature, direction, and use of investment flows,"[45] which can have either a positive or negative effect on the decision-making process of a potential foreign investor.

Countries that want to attract FDI should ensure the existence of the rule of law, stable and transparent governing authorities and independent and impartial judiciaries. The *rule of law* is "a situation in which a set of normative regulations are mandatory and binding on all persons regardless of their power and influence."[46] This means that all institutions and public and private actors should abide by these rules. "The rule of law principle is closely related to basic values such as reliability, stability, accountability and respect for the individual person involved."[47] Further, as

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[44] Jeswald W. Salacuse, "Direct Foreign Investment and the Law in Developing Countries" (2000) 15 ICSID Review 382 at 383.

[45] *Ibid.* at 386.

[46] Daniel D. Bradlow & Alfred Escher, eds., *Legal Aspects of Foreign Direct Investment*, (The Hague: Kluwer Law International, 1999) at 51. According to Black's Law Dictionary, the "rule of law" provides that decisions should be made by the application of known principles or laws without the intervention of discretion in their application. See *Black's Law Dictionary*, 6th ed., s.v. "rule of law".

[47] Bradlow & Escher, *ibid.*

will be mentioned below and in Chapter IV, the judiciary is among the most important of the government institutions which affects FDI.

Foreign investors are discouraged by the existence of restrictive laws that prohibit foreign investments in certain sectors of the host country economy, such as public utilities, transportation, etc.[48] The terms often found in international agreements that hint at the existence of such domestic laws are vague expressions like "national security", "protection of strategic industries", etc.[49] While even developed states like Canada have several FDI restrictions in sectors that hold unique importance to their economy and identity, it is worth underlining that such restrictions should be limited to what is essential to their economies and societies. Otherwise, instead of being a stimulus for safeguarding domestic industries, these restrictions may turn into true obstacles to foreign investors.

Finally, other reasons why domestic laws are important are that they not only attract foreign investment, but they also protect the domestic economy from those foreign investors who are interested only in short-term quick profits and not in the development of the host country, as well as ensuring that new economic development is implemented within the appropriate legal framework and through suitable institutions.[50]

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[48] *Supra* note 44 at 389.

[49] *Ibid.*

[50] Mann, *supra* Chapter I, note 57 at 249-250.

b. Bilateral Investment Treaties (BITs)

In addition to domestic legislation, BITs are important instruments used to regulate the activity and the operation of FDI, especially since, by definition, FDI involves two or more sovereign countries. This section will deal with BITs in general, BITs that Canada has signed with a number of countries (particularly those with Eastern European countries) and their effect on the flow of FDI. Several crucial principles and standards found in almost all BITs will be identified and presented in this section.

Treaties of Friendship, Commerce and Navigation (FCNs) were the forerunner of BITs used from the nineteenth century until the late 1960s, "as one of the most familiar instruments known to diplomatic tradition,"[51] covering a wide range of topics.[52] Their purpose was "to facilitate trade and create a stable diplomatic and economic relationship" between the two parties to the treaty,[53] although after WWII they focused mainly on foreign investment.[54] Many FCNs for Canada were negotiated by the UK before Canada was independently responsible for its treaty

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[51] Herman Walker, Jr., "Modern Treaties of Friendship, Commerce and Navigation" (1957-1958) 42 Minn. L. Rev. 805 at 805.

[52] Mark S. Bergman, "Bilateral Investment Protection Treaties: An Examination of the Evolution and Significance of the U.S. Prototype Treaty" (1983-1984) 16 N.Y.U. J. Int'l L. & Pol. 1 at 4.

[53] Todd S. Shenkin, "Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty" (1993-1994) 55 U. Pitt. L. Rev. 541 at 570.

[54] *Supra* note 52 at 7.

relationships.[55] Even though FCNs after WWII increasingly focused on foreign investment, they still included numerous provisions on many areas of trade, such as international trade, ships and shipping, transit of goods and persons, as well as settlement of disputes.[56] However, the multitude of provisions included in FCNs caused vagueness, thus becoming one of their major drawbacks since it was difficult for investors to use these provisions in the event disputes occurred.[57] Further, bearing in mind the political divisions existing in the world in the 1960s and the 1970s, signing a FCN was considered to be a political alignment with the US or with the developed state with which the treaty was negotiated.[58]

In the late 1950s and early 1960s, these drawbacks caused an evolution in the development of BITs. European countries started negotiating bilateral treaties primarily with developing countries that covered only issues related directly to foreign investment.[59] The first BIT was concluded between the Federal Republic of Germany and Pakistan in 1959,[60] since German investors, after losing their foreign

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[55] Robert K. Paterson, Canadian Investment Promotion and Protection Treaties, (1991) 29 Canadian Y.B. Int'l L. 373 at 373.

[56] *Supra* Chapter I, note 55 at 25.

[57] *Supra* note 52 at 4.

[58] *Ibid.* at 8.

[59] Jeswald W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries" (1990) 24 Int'l L. 655 at 657.

[60] Asoka de Z. Gunawardana, "The Inception and Growth of Bilateral Investment Promotion and Protection Treaties" (1992) 86 Am. Soc'y Int'l L. Proc. 544 at 545.

assets in two world wars, were particularly concerned about their FDI. The OECD drafted the Convention on the Protection of Foreign Property in 1967,[61] a draft which was never ratified.[62] Nevertheless, this convention had quite an impact on later developments and both the US and the UK trace the origins of their BITs to this OECD draft convention.[63] The pace of negotiations of BITs was dawdling until the mid-1970s when the standard of compensation for expropriation became the focus of ideological debates, prompting a series of BITs that attempted to offer an acceptable solution to these debates.[64] The UK signed its first BIT in 1975,[65] while the US, even though it began treaty negotiations in 1977, did not conclude its first BIT until 1982.[66] Today, there are more than 2,000 BITs in existence.[67]

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[61] Draft Convention on the Protection of Foreign Property and Resolution of the OECD on the Draft Convention, OECD Paris, 1967, reprinted in 7 I.L.M. 117 (1968).

[62] J.C. Thomas, "Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators" (2000) ICSID Review For. Inv. L. J. 46 at 46.

[63] *Ibid.* at 49-50.

[64] Kenneth J. Vandevelde, "The Political Economy of a Bilateral Investment Treaty" (1998) 92 Am. J. Int'l L. 621 at 627. Today, the world-wide acceptable solution to the standard of compensation in cases of expropriation is the so-called "Hull formula" of "prompt, adequate and effective compensation". See *infra* text accompanying note 129.

[65] *Supra* note 60 at 545.

[66] *Supra* note 64 at 628.

[67] Jack J. Coe, Jr., "Taking Stock of NAFTA Chapter 11 in Its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods" (2003) 36 Vand. J. Transnat'l L. 1381 at 1397.

Canada took an exceptionally long time to sign its first BIT. Paterson argues that Canada may "have regarded the BIT as incompatible with a high-profile domestic investment policy that many saw as hostile toward foreign ownership."[68] It is important to recall that Canada, at the time of the blooming of BITs, had adopted its FIRA (1973), whose provisions restricted FDI flows into Canada.[69] Also, Canada "justified its failure to enter into such agreements on the basis that they deal partly with matters within provincial jurisdiction."[70] On the international scene, Canada adopted the OECD Declaration on International Investment and Multinational Enterprises[71] in 1976 but still retained the right to impose restrictions upon the entry of foreign investment in Canada, as provided for by FIRA.[72] Canada signed its first BIT – Canada refers to its BITs by the term "Foreign Investment Promotion and Protection Agreements" (FIPAs) – with the Union of Soviet Socialist Republics (USSR) in 1989.[73]

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[68] *Supra* note 55 at 375.

[69] *Supra* Chapter I, note 25.

[70] *Supra* note 55 at 375.

[71] Organization for Economic Cooperation and Development, Declaration on International Investment and Multinational Enterprises, OECD Doc. C(76)99 (Final), reprinted in 15 I.L.M. 967 (1976). This declaration contains the Guidelines for Multinational Enterprises (MNEs), which is a non-binding code of conduct for MNEs.

[72] *Supra* Chapter I, note 56.

[73] *Supra* note 55 at 376. After the disintegration of the USSR, the Russian Federation has taken on the obligations provided for by this FIPA.

As noted, while FCNs included provisions covering various areas of trade and commerce, BITs contain rights and obligations with respect to investments *per se.*[74] Initially, the US Model BIT had three main objectives, as outlined by Vandevelde: a) to provide a solution to the problem of compensation in cases of expropriation[75] (this issue will be discussed in more detail below); b) to protect US investments abroad,[76] and; c) to remove political influence in resolving investment disputes (this too will be analyzed at length below). [77]

While the US issued its revised Model BIT in 1984,[78] Canada, on the other hand, did not formulate a Model BIT at that time; instead a set of widely accepted principles and standards in international investment and trade became the basis for Canada's FIPAs.[79] The two main improvements of the US Model BIT over the older European models were the prohibition on the imposition of performance requirements by the host governments[80] and the reference to an international minimum standard of treatment, (i.e. principles widely accepted by states, such as the national treatment

[74] Pamela B. Gann, "The U.S. Bilateral Investment Treaty Program" (1985) 21 Stan. J. Int'l L. 373 at 374.

[75] Kenneth J. Vandevelde, "U.S. Bilateral Investment Treaties: The Second Wave" (1992-1993) 14 Mich. J. Int'l L. 621 at 625.

[76] *Ibid.*

[77] *Ibid.*

[78] Revised Model Bilateral Investment Treaty, February 24, 1984, reprinted in 20 BNA Export Weekly 960 (May 15, 1984).

[79] *Supra* note 62 at 49-50.

[80] *Supra* note 52 at 18.

and the most-favoured nation (MFN) principles). The US adopted a new Model BIT in November 2004[81] and Canada adopted a Model FIPA also in 2004.[82]

Although a BIT is drafted in a manner that will protect the FDI from each state in the territory of the other, in reality the main objective of a BIT is to protect the investments of the developed country in the developing country treaty partner.[83] This is true because of the inequality of bargaining power between the developed country and its developing country partner.[84] Usually, developed countries draft Model BITs in advance and offer them to developing countries for signature without much modification.[85]

Since investments of developed countries into developing countries usually take numerous forms, generally BITs contain wide definitions of covered investments which cover almost every type and form that these investments may take, such as

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[81] U.S. Department of State - Updated U.S. Model Bilateral Investment Treaty ("BIT"), online: U.S. Department of State <http://www.state.gov/e/eb/rls/othr/38602.htm> (accessed on March 14, 2005)

[82] International Trade Canada, Trade Negotiations and Agreements – Regional and Bilateral Initiative, online: International Trade Canada <http://www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf> (accessed on March 14, 2005).

[83] *Supra* Chapter I, note 55 at 514.

[84] Kenneth J. Vandevelde, "The Economics of Bilateral Investment Treaties" (2000) 41 Harv. Int'l. L. J. 469 at 469. See also Sornarajah, *supra* Chapter I, note 4 at 207.

[85] E.g. compare Canadian FIPA with Romania, Can T.S. 1997/47, Canadian FIPA with Venezuela, Can T.S. 1998/20 and, Canadian FIPA with Panama Can T.S. 1998/35.

shares held in domestic companies, licences, IP, etc.[86] The typical BIT can be divided in two parts. The first part contains provisions that offer clear rules regarding these investments which are binding on the host state.[87] The second part contains provisions that ensure the existence of a fair and impartial dispute resolution mechanism for resolving any investment disagreement that may arise, primarily for disputes between the host state and the foreign investor from the other BIT party.[88]

1. The main principles and standards protecting FDI in BITs

Provisions that define the rules governing FDIs in a host country include: national treatment, most-favoured nation (MFN) treatment, minimum standard of treatment, operational conditions of the investment (which include joint-venture requirements and performance requirements), compensation for losses from armed conflicts or civil disorders, monetary transfers, and clear rules regarding government expropriation and its consequences.[89] In the following section, I will analyse in detail all these types of provisions, extracting general principles and standards, using as examples the FIPAs entered into by Canada.

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[86] *Supra* Chapter I, note 56 at 9.

[87] *Supra* note 44 at 661.

[88] *Ibid.*

[89] *Ibid.* at 664.

i. National treatment & most-favoured nation principles

While BITs do not guarantee the right of access to a country's market,[90] they do contain principles which assure that once the foreign investor has been allowed to establish an investment in the host country, it will be treated fairly and equally with regard to domestic investors and foreign investors of other countries.[91] These assurances are conveyed through the BIT's national treatment and MFN treatment principles.[92] Though similar, as they both require a fair and equal treatment of foreign investors, these are two different principles regulating FDI with regard to the competitors toward whom this fair and equal treatment is required. In this sense, they can be considered as reverse principles: while the national treatment principle requires the host government to provide equality of treatment with respect to the operation of FDI and competition between foreign investors and domestic investors, the MFN principle extends the same non-discrimination obligation to host governments in their treatment of foreign investors compared to other foreign investors from third countries. Both these principles are found in FCNs, in the earlier US Model BIT,[93] and in the 2004 US Model BIT.[94]

[90] *Supra* Chapter I, note 57 at 511. Domestic laws of each country determine the conditions of entry of FDI, e.g. IC Act in Canada provides for those circumstances when foreign investments projects will be submitted for a review at s. 14.

[91] *Supra* note 84 at 97.

[92] *Ibid.* note 44 at 668.

[93] *Supra* note 74 at 384.

[94] Supra note 81 at Articles 3 and 4.

From another perspective, the national treatment and MFN principles appear to be complementary principles.[95] The national treatment principle extends the same rights to foreign investors as those given to domestic investors. But in a situation of a failed state, when domestic investors do not have many rights, the national treatment principle does not offer much protection to foreign investors.[96] However, the MFN principle guarantees that all foreign investors will be treated equally by the host country, providing in this sense equality among foreign investors. In sum, both the national treatment and MFN treatment principles offer what can be considered as 'negative guarantees': the host country is prohibited from taking measures that will treat some investors preferentially, whether domestic or foreign. But, they do not offer 'positive guarantees' that the host country will take measures to improve the rights of domestic or foreign investors. Finally, the MFN principle is widely accepted as required for the general treatment of FDI, while the national treatment principle is still not found in many domestic laws or bilateral treaties.[97]

The national treatment and MFN principles are found in all FIPAs that have been negotiated by the Canadian government. For example, beginning with the first FIPA signed by Canada in 1989 with the USSR,[98] these two principles are found in Article III.[99] The same principles are repeated verbatim in the FIPAs with Poland

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[95] *Supra* note 62 at 26.

[96] *Ibid.*

[97] *Supra* Chapter I, note 55 at 71.

[98] *Supra* note 55 at 376. See also Canadian FIPA with USSR, Can T.S. 1991/31, Article III.

[99] *Ibid.*

(1991)[100] and Hungary (1993),[101] and several of the FIPAs that Canada signed mostly with former Communist countries in the early 1990s. After NAFTA entered into force, the FIPA model used by Canada and principles included in this model were modified considerably, as will be analyzed below. However, the national treatment and MFN principles continued to be included in the bilateral treaties signed in the post-NAFTA period, such as in the FIPAs with Ukraine (1995),[102] Romania (1997)[103] and Croatia (2001).[104] These principles are also found in the 2004 Canadian Model FIPA.[105]

However, caveats to the application of the national treatment and MFN principles are typical features of most BITs. Many areas of trade and commerce that are considered as strategically important for the sovereignty of the host government, such as national defence, police services or especially sensitive issues, such as cultural industries,[106] are excluded from the coverage of the above-mentioned principles.[107] Usually these exceptions or limitations take the form of a list of areas

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[100] Can T.S. 1990/43, Article III.

[101] Can T.S. 1993/14, Article III.

[102] Can T.S. 1995/23, Article III and IV.

[103] Can T.S. 1997/47, Article III and IV.

[104] Can T.S. 2001/4, Article IV.

[105] *Supra* note 82, Article 3 and 4.

[106] *Supra* Chapter I, note 35, at Annex 2106 - Cultural Industries.

[107] *Ibid.*

off-limits to FDI, as appendices to BITs.[108] The US traditionally has negotiated exceptions to both the national treatment and MFN principles in the areas of banking, insurance, ownership of real estate and use of land and natural resources.[109]

ii. Minimum standard of treatment

The minimum standard of treatment is another standard found often in BITs. This standard ensures that each party to the BIT will accord foreign investments of the other party a fair and equitable treatment in accordance with principles of international law and national legislation.[110] While it may be easy to identify the principles of national legislation that will provide for this "fair and equitable treatment," it may not be the same in international law.[111] Therefore, for greater

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[108] For example the Canadian FIPA with Croatia, Can T.S. 2001/4, contains general and specific exceptions to the MFN and the national treatment principles. Croatia and Canada have excluded from the MFN treatment some of their economic sectors, such as aviation, telecommunication transport networks and telecommunication transport services, fisheries and financial services. The national treatment principle is not applicable for investments in the Republic of Croatia in areas such as atomic energy and air transportation, while for Canada one of the restricted areas includes social services.

[109] *Supra* note 74 at 388.

[110] See Canadian FIPA with Romania, Article II(2), Can T.S. 1997/47; Canadian FIPA with Croatia, Article II(2), Can T.S. 2001/4. The minimum standard of treatment is also found in Article 1105(1) of the NAFTA.

[111] The NAFTA Free Trade Commission (FTC) in its interpretation in 2001 described the "fair and equitable treatment" and "full protection and security" as provided for by NAFTA Article 1105(1) to mean the international law minimum standard of treatment of aliens. See International Trade Canada –

certainty, the 2004 Canadian Model FIPA includes an article that clarifies the meaning of the "minimum standard of treatment", stating that this standard implies the international law minimum standard of treatment of aliens.[112] The 2004 US Model BIT goes even further, by describing in detail what is expected by this standard: equal justice in proceedings in accordance with due process and the level of police protection required under customary international law.[113]

iii. Operational conditions of FDI

In the discussion of operational conditions of the investment, the main focus is on joint-venture requirements and performance requirements. These two principles are included in BITs in an attempt to eliminate the control of the host government over the activity of the investment once the foreign investor has set up his activity in the host country.

Joint-venture requirements limit the participation of a foreign investor in an already established (often state-run) enterprise to a stock share of less than 50 per cent so that, practically, the control of the joint company will remain in the hands of the

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Trade Negotiations and Agreements, Dispute Settlement NAFTA - Chapter 11 – Investment, online: Department of Foreign Affairs and International Trade <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp> (accessed March 14, 2005).

[112] *Supra* note 82 at Article 5. This article repeats verbatim the interpretation of the FTC of NAFTA on this matter in 2001. See *supra* note 98.

[113] *Supra* note 81 at Article 5.

host country.[114] "This policy persisted in many Eastern European states even after the fall of communism and the advent of free market economies."[115]

Joint-ventures, which initially may seem easier than setting up a completely new company, often come with a series of burdens, such as the requirement to maintain the current number of employees and the problem of dealing with an outdated and under-developed structure of operation, regardless of the fact that restructuring of the company may be the most preferred option, at least market-wise.[116] Often these companies are the problematic ones, encountering losses instead of profits, employing old technology and, since majority control continues to remain in the hands of the domestic investor (or host government), the foreign investor is quite limited in its operation and control of the company, giving rise to conflicts of interest over the future of the enterprise.[117] In this case, evidence seems to indicate that foreign investors are reluctant to invest in the most advanced technology, as there is more risk that this technology may be appropriated by the local partners.[118] In addition, these limitations increase the amount of risk and the cost of doing business

[114] *Supra* note 44 at 390.

[115] *Supra* Chapter I, note 56 at 120.

[116] Marek Wierzbowski, "Foreign Investment in Eastern Europe – an Insider's View" (1991) 4 Transnat'l Law. 623 at 630. See also Geoffrey D. Swindler, "Joint Ventures in the Soviet Union: Problems Emerge" (1989-1990) 13 U. Puget Sound L. Rev. 165 at 193.

[117] Stanley J. Paliwoda, *Investing in Eastern Europe: Capitalizing on Emerging Markets* (Cambridge: Cambridge University Press, 1995) at 12-13.

[118] *Supra* note 44 at 390.

and, at the same time, lower profits, making the host country less attractive to foreign investors.

The second restriction, performance requirements, limit the foreign investor's possibilities for operating in a free market environment: foreign investors are required to purchase a certain amount of locally produced raw material or products, or to export a minimum quota of its products.[119] However, domestic products, whether raw or processed, may be scarce, expensive, of an inferior quality or plainly not suitable for incorporating in the final product or the objectives of the investor. Occasionally, performance requirements may include additional requirements that call for the appointment of senior officials in the enterprise or on its board of directors who are nationals of the host state. One argument against imposing performance requirements and joint-venture requirements is that these requirements are not imposed upon domestic investors and, since foreign investments are expected to be treated the same as domestic investments under the national treatment principle, then these performance requirements should be abolished altogether.[120]

Finally, with regard to performance and joint-venture requirements, both may be counterproductive.[121] This may be because foreign investors may fear technology

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[119] *Ibid.* at 390-391.

[120] *Supra* Chapter I, note 56 at 234.

[121] *Supra* Chapter I, note 55 at 520-521. See also Juergen Kurtz, "A General Investment Agreement in the WTO - Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment" (2003) 23 U. Pa. J. Int'l Econ. L. 713 at 727.

leakage, since they have to share the technology they import with the domestic partner in the joint-venture.[122] There is evidence that local participation "may be greater where the host state does not require it."[123]

The US and Canada have been adamant that prohibitions of performance requirements be included in their investment treaties.[124] However, the prohibition of performance requirements began to appear in Canada's FIPAs only in 1995, in the FIPA signed with Ukraine.[125] It seems that this development was influenced by NAFTA Chapter 11 which, as we will see in the following section, has influenced many of Canada's BITs entered into since 1994. Subsequently, similar provisions prohibiting performance requirements are found in all FIPAs that Canada has signed.

iv. Expropriation and compensation

Government expropriation, in the form of confiscation or/and nationalisation, used to be one of the greatest concerns of foreign investors. Examples of lawful or unlawful expropriations occurring since the end of WWII range from German investors' loss of almost all their possessions overseas,[126] to the nationalisation of

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[122] Richard E. Caves, *Multinational Enterprise and Economic Analyses*, 2nd ed. (New York: Cambridge University Press, 1996) at 170.

[123] *Supra* Chapter I, note 55 at 520-521.

[124] *Ibid.* at 237.

[125] Can T.S. 1995/23, Article V.

[126] *Supra* note 59.

several foreign companies in France in the early 1980s.[127] The earlier US Model BIT provides for rules regarding expropriation in Article III, paragraph 1.[128] It offers the now famous formula of "prompt, adequate and effective compensation" in cases of expropriations.[129] While BITs cannot provide full protection for foreign investments in the host country, at least they can limit the authority of the government in the areas of expropriation and nationalization which, although still allowed, may be carried out only under certain circumstances.[130] In Canada's FIPAs, these circumstances include, but are not limited to: public purpose; under due process of law; in a non-discriminatory manner; against prompt, adequate and effective compensation.[131] The foreign investors also reserve the right to demand a review of the expropriation decision of the host government by a judicial or other independent authority of that

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[127] Michel Henry Bouchet et al., *Country Risk Assessment: A Guide to Global Investment Strategy* (Chichester: John Wiley & Sons, 2003) at 21.

[128] *Supra* note 74 at 398.

[129] This formula, also known as the "Hull formula" was first used by the US Secretary of State Cordell Hull during the Mexican expropriations in the 1940s. See *supra* Chapter I, note 56 at 438.

[130] The earlier US Model BIT lists as circumstances when the expropriation is allowed the following: done for a public purpose; accomplished under due process of law; not discriminatory; not contrary to any specific agreement between the national or company concerned and the Party making the expropriation and accompanied by prompt, adequate and effective compensation. See also *supra* note 62, at 398.

[131] See Canadian FIPA with Argentina, Can T.S. 1993/11, Article VII(1), Canadian FIPA with Latvia, Can T.S. 1995/19, Article VIII(1)

Party.[132] The importance of expropriation concerns is evidenced by the fact that provisions related to expropriations are found in all Canadian FIPAs.[133]

v. Monetary transfers

The standard of government expropriation and its specific circumstances cannot be analysed apart from the standards of monetary transfers. This standard is closely related to the transfer of the compensation awarded in cases of lawful expropriation by the host government. In these and other cases, the compensation should be "unrestricted," provided without delay, in the convertible currency in which the capital was originally invested or other currencies as agreed by both parties concerned and at the exchange rate applicable on the date of transfer.[134] Other sources of monetary transfers, besides compensation for expropriation, include funds in repayment of loans related to investments, proceeds of total or partial liquidation of any investment, wages and other remuneration of foreign staff, bank interest and finally, but obviously the most important, transfer of the investment and its returns.[135]

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[132] See Canadian FIPA with Argentina, Can T.S. 1993/11, Article VII(2), Canadian FIPA with Latvia, Can T.S. 1995/19, article VIII(2)

[133] E.g. see Canadian FIPA with USSR, Can. T.S. CTS 1991/31, Article V and VI, and Canadian FIPA with Costa Rica, Can. T.S. 1999/43, Article VI and VII.

[134] See Canadian FIPA with the Czech and Slovak Federal Republic, Can T.S. 1992/10, Article VII(1) and VII(2).

[135] See Canadian FIPA with the Czech and Slovak Federal Republic, Can T.S. 1992/10, Article VII(1) and VII(2). See also Canadian FIPA with Egypt, Can T.S. 1997/31, Article IX(1) and IX(2).

The FIPA with Egypt adds more details on how rules of compensation shall not be used (or abused) to allow fraud in trading or dealing in securities, bankruptcy or insolvency and criminal or penal offences, etc.[136]

2. Dispute resolution mechanisms: arbitration

Even though BITs provide for the opportunity of international arbitration in order to settle investment disputes, nevertheless, the value of an independent domestic court system in the host state still remains. As foreign investors cannot take all disputes to permanent or *ad hoc* international arbitration tribunals, domestic courts will continue to remain a venue where these disputes need to be addressed.[137] As such, the justice institutions and the legal systems of host countries need to be reliable and impartial, in order that foreign investors may feel confident in using them, with the complete trust that domestic courts will act impartially and fairly.

When it was initially drafted, the 1984 US Model BIT provided for all disputes between investors and the host country to be submitted for review by the International Court of Justice (ICJ) unless the parties agreed otherwise; but after 1992 ICSID replaced the ICJ.[138] The parties are always free to choose another arbitration

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[136] See Canadian FIPA with Egypt, Can T.S. 1997/31, Article IX(3).

[137] Bradlow & Escher, *supra* note 46 at 43.

[138] *Supra* note 75 at 657; *supra* note 78 at Article VIII(2). Since the ICJ only takes contentious cases between states, the investor would not have had standing to appear and would have been represented by its state.

institution to settle their disputes or to opt for *ad hoc* arbitration tribunals.[139] Canadian FIPAs initially provided for ICJ jurisdiction over arbitration when the parties had not agreed on another institution for their investment disputes and, after 1993, FIPAs provided for host state-foreign investor arbitration under the ICSID Convention or the UNCITRAL Arbitration Rules.[140]

An important change in this aspect in US BITs in the 1990s was in the area of arbitration of investment disputes.[141] By signing the BIT, now the host state automatically consented to the dispute resolution mechanism specified in the BIT.[142] In this way, it became unnecessary to demand that the host government consent to arbitration in each case. This change was also reflected in Canadian FIPAs. While Canadian FIPAs signed before 1992 contained only a general provision on arbitration (that any dispute between the two states shall be submitted to an arbitral tribunal for decision, at the request of each contracting state), FIPAs signed since 1993 contain more detailed provisions regulating the procedure for establishing an arbitration

[139] *Ibid.* at Article VIII(8).

[140] Compare Canadian FIPA with Poland, Can T.S. 1990/43, Article XI(4), Canadian FIPA with Venezuela, Can T.S. CTS 1998/20, Article XII(4), Canadian FIPA with Panama, Can T.S. 1998/35, Article XIII(4) and, Canadian FIPA with Armenia, Can. T.S. 1999/22, Article XIII(4).

[141] See for example Treaty between the United States of America and the Republic of Poland Concerning Business and Economic Relations, Mar. 21, 1990, S. treaty Doc. No. 18, 101st Cong., 2nd Sess. (1990). Most of the provisions of the BIT have served as examples for BITs signed later by the US and other states.

[142] *Supra* note 63 at 657.

tribunal and, for the first time, also provide a venue for the investor (private individual or company) to start an arbitration proceeding in case of violation of his rights as an investor.[143] This important change was influenced by NAFTA Chapter 11, which has influenced post-1994 Canadian BITs, with respect to two main innovations.

c. NAFTA Chapter 11

The NAFTA entered into force in on January 1, 1994.[144] This agreement formed a free trade area that had a total market of 373 million people and a total gross domestic product (GDP) of US$6.8 trillion.[145] At the time, NAFTA was the largest free trade area in the world.[146] While it is based on and supersedes the CUFTA,[147] NAFTA is a very important agreement because of its effects on the three signatory

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[143] Compare Canadian FIPA with Poland, Can T.S. 1990/43, Article XI and Canadian FIPA with Argentina, Can T.S. 1993/11, Article V. See especially Canadian FIPA with Venezuela, Can T.S. CTS 1998/20, starting with Article XII, which contains much longer and clearer provisions on the process of arbitration.

[144] *Supra* Chapter I, note 35.

[145] Joseph J. Norton & Thomas L. Bloodworth, eds., *NAFTA and Beyond: A New Framework for Doing Business in Americas*, (Dordrecht: Martinus Nijehoff Publishers, 1995) at 527.

[146] *Ibid.*

[147] John D. Richard, Q.C.& Richard G. Dearden, *The Canada-US Free Trade Agreement, Final Text and Analysis* (Ontario: CCH Canadian Limited, 1988) at 91. Since April 2004, the 25 member state EU became the largest trading bloc in the world.

states and the new concepts it offers in the area of FDI. NAFTA's investment chapter was based on the 1984 US Model BIT.[148]

The earlier CUFTA included in its objectives the significant liberalization of conditions for investment within this free-trade area and the establishment of effective procedures for the resolution of disputes.[149] To this purpose, CUFTA Chapter 16 was dedicated to investment protection and Chapter 19 to dispute settlement. As a free trade agreement between two developed countries with enormous mutual trading activities and vast experience in the negotiation of BITs, CUFTA Chapters 16 and 19 contained all the standards and principles prescribed up to 1987 in the BITs signed by the US with other countries.[150] The CUFTA did not provide for any host state-foreign investor arbitration and extended its protection to businesses constituted and organized within the territories of the two member States if they were owned by Canadian and US nationals.[151] In a major change to this earlier

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[148] Jon R. Johnson, *The North American Free Trade Agreement – A Comprehensive Guide* (Ontario, Canada Law Book Inc., 1994) at 278. See also Barry Appleton, *Navigating NAFTA: A Concise User's Guide to the North American Free Trade Agreement*, (Ontario: Carswell, 1994) at 79.

[149] United States – Canada Free Trade Agreement, 27. I.L.M. 293 (1988) at Article 102.

[150] Chapter 5, Article 501 of CUFTA contains the principle of national treatment of goods, CUFTA Chapter 16, Article 1602 provides for the national treatment of investments, Article 1603 covers performance requirements, Article 1605 deals with expropriation, Article 1606 with transfers and, Article 1608 with disputes. See *ibid.*

[151] See *supra* note 149 at Article 1602.

regime, the NAFTA makes no distinction in the level of protection granted by its provisions because of citizenship.[152]

The three basic components of Chapter 11 are as follows:

> a) The scope of coverage: what types of investments and investors are covered, and what types of government actions; b) The rights of foreign investors or, conversely, the obligations that states have towards foreign investors; and c) The process for handling disputes between foreign investors and host countries.[153]

One author has described NAFTA Chapter 11 as "a BIT inserted into a multi-lateral free trade agreement."[154] The main objectives of Chapter 11, according to Brower and Steven are the following:

> a) to tear down existing foreign investment barriers by eliminating arbitrary and discriminatory restrictions; b) to build investor confidence throughout the region through the elaboration and enforcement of clear and fair rules; and c) to "depoliticize" the resolution of investment disputes by eliminating the need for State-to-State adjudication.[155]

Chapter 11 begins with the well-known national treatment, MFN and minimum standard of treatment principles in Article 1102, Article 1103 and Article

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[152] See *supra* Chapter I, note 35 at Article 1103.

[153] Mann, *supra* Chapter I, note 41.

[154] Jack J. Coe, Jr., "Taking Stock of NAFTA Chapter 11 in Its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods" (2003) 36 Vand. J. Transnat'l L. 1381 at 1391.

[155] Charles N. Brower & Lee A. Steven, "Who Then Should Judge: Developing the International Rule of Law under NAFTA Chapter 11" (2001) 2 Chi. J. Int'l L. 193 at 195.

1105 respectively. Even though Mexico had made numerous changes in its domestic legislation with the intention of bringing it up to international economic liberal standards,[156] it was considered necessary to repeat those obligations in an international agreement to encourage foreign investors. As Bergman notes, BITs offer "...the sense of security that flows from a legal commitment, in which the rights and obligations of each party are set forth in advance...."[157] In other words, the investor faces fewer risks that changes in domestic laws or foreign policy of the host state will affect his investment negatively, and even the mere reduction of risk encourages investment.[158]

The first important innovation of the NAFTA was the introduction of stronger provisions prohibiting performance requirements, in Article 1106(1) and (3).[159] They are clear that no party may impose on foreign investors specific quotas for exports or requirements related to the level or percentages of domestic content in their products or services, or purchases of goods or services provided in its territory. The performance requirement is complemented by Article 1107(1), which provides for independence of investors when making decisions about the senior staff of their

[156] Mexico, in preparation for the NAFTA to enter into force, adopted the Foreign Investment Law, which entered into force on December 28, 1993. *Supra* Bradlow & Escher, note 46 at 479.

[157] *Supra* note 52 at 10.

[158] *Supra* note 59 at 661.

[159] These provisions have fewer exceptions and are more detailed compared to the CUFTA counterpart. See earlier, weaker provisions in CUFTA Article 1603, *supra* note 149.

enterprises or operations.[160] The importance of these provisions is understood when taking into account that NAFTA includes Mexico, a developing country member state, thus creating a precedent or model for future BITs entered into by Canada or the US with developing countries. Indeed, these provisions influenced the inclusion of similar language in Canada's BITs drafted subsequently.[161]

The inclusion of a provision on expropriation, in NAFTA Article 1110, was a considerable achievement when taking into account that Mexico had been a staunch supporter of the Calvo doctrine for over a century.[162] All legal instruments of the Mexican legislative system traditionally imposed great restrictions on foreign

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[160] However, NAFTA Article 1107(2) provides also a restriction: the majority of a board of directors or any committee may be required to be of a particular nationality or resident in the territory of the Party demanding this requirement, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment. See *supra* Chapter I, note 35.

[161] Compare NAFTA, Article 1106 with Article V of the Canada FIPA with Latvia, Can T.S. 1995/19, Article V of the FIPA with the Philippines, Can T.S. 1996/46 and Article V of the FIPA with Romania Can T.S. 1997/47.

[162] The so-called "Calvo doctrine" originated from the writing of Carlos Calvo, a lawyer from Argentina. In his work, *Le Droit International* (1986), Calvo claimed that a country is not liable for damages suffered by aliens in time of riots or insurrections. Thus, according to Calvo, foreign investors should be treated no different then domestic investors, thus no favourable treatment should be allowed. See Percy Bordwell, "Calvo and the Calvo Doctrine" (1906) 18 Green Bag 377 at 380-381.

ownership and foreign investment in Mexico.[163] In 1937, the Mexican state nationalized the foreign oil and gas industries[164] and in 1960 the electric power was nationalised.[165] In 1973 Mexico enacted its first foreign investment law[166] which introduced several small changes. After the 1982 debt crisis in Mexico, it was obvious that the foreign investment regime had to be liberalized, and the Mexican government realized that liberalization had become "a necessary precondition for growth."[167] However, it was not until 1989 that the climate for foreign investment in Mexico changed for the better, with the introduction of a set of regulations[168] that abolished all previous laws and regulations on FDI in Mexico.[169]

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[163] For example, the Mexican Constitution (1917), Article 27, paragraph 1, prohibits foreigners from purchasing real estate within 100 km from the border of the country. See Guillermo Emiliano del Toro, "Foreign Direct Investment in Mexico and the 1994 Crisis: A Legal Perspective" (1997-1998) 20 Hous. J. Int'l L. 1 at 7.

[164] Ralph H. Folsom, *NAFTA and the Free Trade in the Americas* (St. Paul: West Thomson, 2004) at 152.

[165] Del Toro, *supra* note 163 at 9.

[166] Ley Para Promover la Inversion Mexicana y Regular la Inversion Extranjera, D.O., 9 de marzo de 1973. *Ibid.*

[167] Nora Lustig, *Mexico. The Remaking of an Economy* (Washington, D.C.: The Brookings Institution, 1992) at 182.

[168] Reglamento de la Ley Para Promover la Inversion Mexicana y Regular la Inversion Extranjera, D.O., 16 de mayo de 1989. See del Toro, *supra* note 163.

[169] These regulations removed the 49 percent restriction on foreign ownership in those industries that were not reserved exclusively for the state or for Mexican nationals. See *supra* note 147 at 183.

Once the negotiations on NAFTA began, Mexico had to make important changes in its domestic laws on FDI. These changes were reflected in the enactment of a new law on foreign investments in 1993[170] which allows foreign investors unlimited participation in Mexican enterprises, offers them the possibility to enter new economic areas or introduce new lines of products, but with numerous limitations.[171] Several other laws adopted by Mexico before and after NAFTA[172] sealed the fate of Mexico's future in the realm of FDI and hammered the last nail in the coffin of the Calvo doctrine.[173] Mexico departed from its traditional stance, when all investment disputes were under the jurisdiction of domestic administrative tribunals and courts.[174] Under immense pressure and lobbying from the US[175] in signing the NAFTA Mexico agreed to give up the Calvo doctrine and accept the

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[170] Ley de Inversion Extranjera, D.O., 27 de diciembre de 1993 as amended by D.O., 18 de diciembre de 1996. See del Toro, *supra* note 163.

[171] Del Toro, *ibid.* at 20.

[172] For an extended list of laws affecting the FDI regime in Mexico enacted before and after NAFTA came into force see del Toro, *supra* note 163 at 56-57.

[173] Justine Daly, "Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico after the NAFTA" (1994) 25 St. Mary's L.J. 1147 at 1161.

[174] Maximo Romero Jiminez, "Considerations of NAFTA Chapter 11" (2001) 2 Chi. J. Int'l L. 243 at 243.

[175] *Supra* note 155 at 194.

jurisdiction of independent international arbitration tribunals in cases of investment disputes between the government and foreign investors from other NAFTA states.[176]

Article 1110 of the NAFTA also prohibits "other measures tantamount to expropriation or nationalization". While not directly stripping the investors of their property, these so-called "creeping expropriations"[177] have the same effect on the control of the investor over its investment. Such measures may include actions of governments that create obstacles to the practical use of the investment,[178] for example fiscal measures,[179] forced sales of property, forced sales of shares, excessive taxation and freezing of bank accounts.[180]

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[176] Besides Mexico, today more than twenty countries in Latin America, once fierce supporters of the Calvo doctrine, have already concluded BITs "that provide for international arbitration of claims by investors against the host state." See Vandevelde, *supra* note 84 at 470.

[177] *Supra* note 174 at 245.

[178] An example of measures tantamount to expropriation is found in the award given in the first dispute case under NAFTA Chapter 11, Metalclad Corp. v. Mexico, Award, ICSID Case No. ARB(AF)/97/1 (2000). In this case, a certain area was declared part of an ecological preserve by local officials (after the foreign investor had been issued the permit to use this land as a construction site by central government officials), thus not allowing him to invest there. The full text of the award may be found in (2001) 16 ICSID Review 168.

[179] Guillermo Aguilar Alvarez & William W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365 at 367.

[180] *Supra* Chapter I, note 56 at 359.

The second important innovation of NAFTA is that investors can begin an arbitration proceeding regardless of the position of their government on this matter. While Chapter 20 provides a venue for the settlement of disputes among the state parties to the agreement, Section B of Chapter 11 provides a dispute settlement procedure involving investors of one NAFTA state and another NAFTA government.[181] On this issue, Jones argues that "the Chapter 11 dispute resolution regime is indeed a "shield" necessary to protect foreign investors...."[182] This dispute resolution system "acts as a good example of rule-based diplomacy."[183] In this way investors have a way of pursuing their legitimate interests allegedly infringed by a NAFTA government when their own government is not keen to raise the matter or may not be prompt in initiating an arbitration procedure because of the political and foreign policies consequences arising from such actions.[184] NAFTA was the first multilateral agreement that provided for this type of protection for foreign investors.[185]

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[181] Richard G. Lispey et. al., *The NAFTA: What's In, What's Out, What's Next.* (Ottawa: Renouf Publishing Company Limited, 1994) at 120.

[182] Ray C. Jones, "NAFTA Chapter 11 Investor-to-State Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared?" (2002) BYU L. 527 at 528.

[183] Justin Byrne, "Comment, NAFTA Dispute Resolution: Implementing True Rule- Based Diplomacy Through Direct Access" (2000) 35 Tex. Int'l L.J. 415 at 416.

[184] Jean Anderson & Jonathan T. Fried, "The Canada-U.S. Free Trade Agreement in Operation" (1991) 17 Can.-U.S. L.J. 397 at 397.

[185] Marcia J. Staff & Christine W. Lewis, "Arbitration under NAFTA Chapter 11: Past, Present, and Future" (2002-2003) 25 Hous. J. Int'l L. 301 at 308.

However, recently there have been developments that indicate a trend of withdrawal from this liberal process of arbitration of investment disputes. Commentators have suggested the adoption of binding interpretive statements, the establishment of a permanent appellate body for reviewing the decisions of arbitration tribunals, the restoration of the state-state arbitration mechanism or the establishment of a permanent standing court that would adjudicate all investment dispute claims.[186] NAFTA governments have tried to take the easy way out by use of commercial arbitration proceedings in domestic courts, arguing that awards should be set aside or not enforced in those cases when arbitral tribunals have decided on behalf of the aggrieved investors in the form of monetary awards, "transforming municipal courts into the final arbiters of investor-state disputes."[187] Also they have sought to narrow

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[186] Joel C. Beauvais, "Regulatory Expropriations under NAFTA: Emerging Principles and Lingering Doubts" (2001-2002) 10 N.Y.U. Envtl. L.J. 245 at 294; Samrat Ganguly, "The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health" (1999-2000) 38 Colum. J. Transnat'l L. 113 at 166; Daniel R. Loritz, "Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed under NAFTA's Chapter 11" (1999-2000) 22 Loy. L.A. Int'l & Comp. L. Rev. 533 at 548; Herman L. Lawrence "Settlement of International Trade Disputes--Challenges to Sovereignty--A Canadian Perspective" (1998) 24 Can.-U.S. L.J. 121 at 136.

[187] Charles H. Brower, II., "Investor-State Disputes under NAFTA: The Empire Strikes Back" (2001-2002) 40 Colum. J. Transnat'l L. 43 at 62. See also *The United Mexican States v. Metalclad Corp.*, (2001), 89 B.C.L.R. (3d) 359. In this case, the court in British Columbia largely upheld the decision of the arbitration tribunal. For the arbitration tribunal decision see *supra* note 165. See also United Mexican States v. Marvin Feldman, available at <http://www.ontariocourts.on.ca/decisions/2005/january/C41169.pdf> (accessed March 14, 2005). In this case, the Court of Appeal in Ontario dismissed the appeal of Mexico to set aside the arbitration

the scope of liability under the NAFTA by issuing interpretations of various NAFTA articles.[188] These trends arise from the position of NAFTA countries as host countries subject to arbitral claims by foreign investors, especially with the first cases filed against the US and Canada under NAFTA Chapter 11.[189]

Another important innovation that has considerably affected the FIPAs signed by Canada in the post-NAFTA period is the high level of protection for IP introduced by NAFTA, Chapter 17. Knowing the importance of IP in contemporary world trade,[190] IP protection has increasingly become an integrated part of BITs. Some authors believe that "the inadequate protection of intellectual property and related

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award. For the arbitration tribunal decision see Marvin Roy Feldman Karpa v. United Mexican States ICSID Case No. ARB(AF)/99/1 (2002). The full text of the award may be found in (2003) 18 ICSID Review 168.

[188] David A. Gantz, "The evolution of FTA investment provisions: from NAFTA to the United States - Chile Free Trade Agreement" (2004) 19 Am. U. Int'l L. Rev 679 at 687. The full text of the interpretation of Article 1105 may be found at International Trade Canada – Trade Negotiations and Agreements, online: International Trade Canada <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp> (accessed March 14, 2005).

[189] *Supra* note 179 at 370, 383.

[190] Both the World Trade Report 2003 and the World Investment Report 2004 underline the increasing significance of the IP in international trade and its effect in attracting certain kinds of FDI. For more information see WTO, *World Trade Report 2003* (Geneva: WTO, 2003) at 167 and UNCTAD, *World Investment Report 2004: The Shift Toward Services* (New York and Geneva: United Nations, 2004) at iii.

services is viewed as a non-tariff barrier to trade,"[191] especially if we take into account that developing countries have the tendency to disregard the protection of IP even though they are parties to international conventions adopted to protect these IP rights.[192]

The U.S. is considered one of the main producers of IP in the world[193] and, taking into account the economic impact and the loss of revenues[194] from inadequate protection of IP in developing countries, it made sense for the U.S. to be very active in negotiating bilateral, regional and multilateral agreements on IP issues. In this context the U.S. insisted that IP protection needed to be included in the GATT multilateral trade negotiating round that began in September 1986 in Punta del Este,

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[191] Catherine Brown & Christine Manolakas, "Trade in Technology within the Free Trade Zone: The Impact of the WTO Agreement, NAFTA, and Tax Treaties on the NAFTA Signatories" (2000-2001) 21 Nw. J. Int'l L. & Bus. 71 at 72.

[192] *Supra* Chapter I, note 56 at 47.

[193] William M. Landes & Richard A. Posner, *The Economic Structure of Intellectual Property Law* (Cambridge: Harvard University Press, 2003) at 2.

[194] For a in-depth discussion on the effect of piracy on intellectual property see Benedicte Callan, *Pirates on the High Seas: The United States and Global Intellectual Property Rights* (New York: Publications Office, 1998) at 30, 32 and 34. According to the 2004 Special 301 Report of the Office of the United States Trade Representative, losses because of piracy and counterfeiting to US industries alone are estimated at $ 200 to $ 250 billion per year. Full report is available at Office of the United States Representative – Intellectual Property, online: Office of the United States Representative <http://www.ustr.gov/Document_Library/Reports_Publications/2004/2004_Special_301/Section_Index.html> (accessed on March 14, 2005).

Uruguay,[195] and which resulted in the signing of the TRIPS Agreement – part of the WTO Agreement and now one of the main treaties on the protection of IP.

From a regional perspective, the US insisted on introducing IP protection as part of the NAFTA negotiations, especially since Mexico was not a party to the Berne Convention,[196] (which is one of the two pillars for worldwide IP protection – the other one being the Paris Convention).[197] Mexico's IP laws contained restrictive provisions on the rights of IP holders[198] and Mexico maintained the position that "technology belongs to all mankind, and consequently, any proprietary rights to ideas or concepts become unacceptable, particularly if industrialized nations which create the technology hold those rights."[199] However, while NAFTA was being negotiated, Mexico adopted new IP legislation as part of its efforts to attract FDI and to achieve trilateral agreement on the provisions of NAFTA.[200]

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[195] *Supra* note 12 at 254.

[196] Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, 828 U.N.T.S. 221 (1972) (as amended). See also Appleton, *supra* note 148 at 123.

[197] Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 828 U.N.T.S. 305 (as amended).

[198] Gabriel Garcia, "Economic Development and the Course of Intellectual Property Protection in Mexico" (1992) 27 Tex. Int'l L. J. 701 at 724.

[199] *Ibid.* at 728.

[200] For more information see "Law for the Promotion and Protection of Industrial Property," D.O., June 27, 1991, as amended by D.O. of August 2, 1994; Regulation for the Promotion and Protection of Industrial Property, D.O. of November 23, 1994.

As far as Canada was concerned, it was able to maintain in the NAFTA its wide restrictions on FDI in its so-called "cultural industries," which includes those industries engaged in activities related to the publishing of books and periodicals, films, videos, audio or video recordings, radio, television and satellite programming and broadcasting.[201] According to NAFTA, Annex 2106, Canada's cultural industries are subject to different procedures that attempt to guarantee Canadian sovereignty over industries that are considered extremely vital to Canadian culture and identity.[202]

IP protection is addressed separately in NAFTA Chapter 17. While previous BITs contained provisions on the protection of IP, Chapter 17 takes this protection one step further by, on the one hand, providing protection for new kinds of IP rights that had been left outside the Berne Convention even after its amendments in 1971 and, on the other hand, requiring higher standards for old IP rights.[203] Chapter 17

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[201] NAFTA, Articles 2106 and Article 2107. See *supra* Chapter I, note 35. These articles reiterate the restrictions of IC Act, Article 14.1(5)(d), where it provides that for cultural businesses the review procedure is obligatory based on a lower threshold of invested capital than for other industries.

[202] *Supra* note 191, at 72. NAFTA Annex 2106 – Cultural Industries provides that cultural industries will be exempt from the provision of the NAFTA agreement. This Annex refers to the CUFTA, where in Article 2005 it is provided that cultural industries are exempt from the provisions of that agreement. However, CUFTA Article 2005(2) allows a party to take measures in response to actions that would have been inconsistent with this Agreement. See *supra* Chapter I, note 35.

[203] See Article 1705(2) and Article 1707(1) of the NAFTA, *supra* Chapter I, note 35. See also John E. Vick, Jr., "Intellectual Property Aspects of NAFTA and GATT: An Update" (1993-1994) 2 Tex. Intell. Prop. L. J. 131 at 132.

also guarantees the enforcement of IP rights in cases of violations.[204] However, since NAFTA defines IP as "intangible property" in Article 1139(g), it opens the way for the investor-state arbitration dispute mechanism in Chapter 11 to be used, permitting the investor to start an arbitration procedure against a host government that violates its IP rights.

As Vandevelde rightfully notes, host governments can provide all the standards and principles included in BITs without ever negotiating or signing one with a developed country.[205] Yet, the mere existence of a BIT does not necessarily mean that FDI will immediately flow to these countries as soon as the treaty is signed by the respective authorities. Nonetheless, BITs are important as they provide the visible legal investiture of these commitments by the host government in an international setting, with the promise of honouring these obligations.[206] While BITs amplify and advertise on the international level the efforts of host governments to attract FDI, they do not guarantee that the host state will provide the market economy conditions where FDI will grow and prosper.

As no BIT provides for host states to allow inward investment flows without any review or permission from the host government,[207] it is necessary to stress once more that it is extremely important to have local laws in place which govern these

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[204] See Article 1714 of NAFTA, *supra* Chapter I, note 35.

[205] *Supra* note 84 at 488.

[206] *Ibid.*

[207] *Supra* Chapter I, note 55 at 511.

issues. While BITs are expressions of general policy statements to attract foreign investments, additional domestic laws which would govern the application of these principles and standards are even more important than the BIT "diplomatic" statement of good will and joint co-operation in trade and commerce. As the practice indicates, when adjudicating on foreign investment disputes, arbitral tribunals have pointed to the importance of having sound legal instruments in place.[208] Finally, BITs "do not aid the investor in establishing the investment, but do prohibit discrimination once the host state has permitted the investment to be established."[209] The host state retains complete discretion, regardless of the number of BITs it has signed, to decide whether to allow a certain investment or investor to operate within its territory.

d. Beyond NAFTA Chapter 11: the future of BITs

As noted earlier, there are more than 2,000 BITs in existence, many of them signed after NAFTA entered into force.[210] I will analyze the evolution of BITs in the post-NAFTA period by focusing on the new US Model BIT, approved by the Department of State and the Office of the United States Trade Representative (USTR)

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[208] In the Metalclad case, the arbitration tribunal concluded that domestic laws regarding foreign investments in NAFTA countries should be clear, determined and widely available to foreign investors. See e.g. Brower, *supra* note 174 at 58.

[209] *Supra* Chapter I, note 55 at 511.

[210] *Supra* note 67 at 1397.

in November 2004[211] and the new Canadian Model FIPA, adopted in 2004.[212] I will discuss the positive and negative trends in these new treaty models and possible future improvement to BITs.

1. 2004 Canadian Model FIPA

The new FIPA model is more than twice as long as previous FIPAs and contains 52 articles, 4 annexes and a side letter on the code of conduct of arbitrators as agreed by parties at a latter date.[213] Obviously the Canadian government is striving to provide maximum clarity, transparency and efficiency in the provisions of future FIPAs.[214] As I will discuss below, most changes and improvements in the text of the Model FIPA are directed to this effect.

The most important developments in the new Model FIPA regard the investor-state dispute arbitration process, which had turned into a nightmare after the adoption of NAFTA Chapter 11. Issues in focus deal with "the scope of expropriation, public access to hearings and documents, and non-disputing party submissions."[215] Annex

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[211] *Supra* note 81.

[212] *Supra* note 82.

[213] Compare with FIPA with Croatia, Can T.S. 2001/4, the latest FIPA negotiated by Canada which contains only 15 articles and 2 annexes.

[214] See Andrew Newcombe, "Canada's New Model Foreign Investment Protection Agreement" (Fall 2004) 30 CCIL Newsletter 3 at 9.

[215] *Ibid.*

B. 13(1) is intended to clarify the meaning of "indirect expropriation" and how to determine whether a measure taken by one of the parties amounts to "indirect expropriation." This provision avoids the confusion created by vague expressions such as "measures tantamount to expropriation" found in NAFTA Article 1110(1).

In a breakthrough in the dispute settlement mechanism, the new Model FIPA provides for the establishment of a Commission, "comprising cabinet-level representatives of the Parties or their designees."[216] The requirement for the creation of this Commission is very important because it will have extensive powers over the arbitration process including, but not limited to, the supervision of the implementation of the agreement, the adjudication of disputes regarding its interpretation or application, and the adoption of a Code of Conduct for Arbitrators.[217] The Commission's interpretation of a provision of the agreement shall be binding on an arbitration tribunal, even with regard to any award given.[218] Public access to hearings and documents of arbitral tribunal proceedings is made possible by Article 38, and any non-disputing party retains the right to file submissions with the tribunal according to Article 39, with certain exceptions that protect confidential and privileged information.

[216] Article 51(1) of the new FIPA model, *supra* note 82.

[217] *Ibid.* at Article 51(2).

[218] *Ibid.* at Article 40(2).

Other smaller changes include the expansion and clarification of the definition of "investment" in Article 1 of the Model FIPA and the limitation on the MFN treatment principle in Annex III, providing that the MFN treatment principle shall be considered separately from other bilateral or multilateral agreements signed by both countries both prior to and after the date of entry into force of the Agreement. However, since no agreements have yet been negotiated based on the new Model FIPA,[219] it is still too early to speculate on the effect of this model on future FIPAs. One thing is sure though: the objective of the new FIPA is to strike a balance between investors' rights and the public interest of the home state. Now investment treaties will resemble more closely two-way streets, in which investment will flow from each country to the other and provisions which are necessary to guarantee that investors' rights do not became obstacles blocking the state's sovereign right to exercise its powers in serving its citizens.[220] Finally, Canada has attempted to ensure some degree of supervision and control over the possible arbitration processes involving investor-state disputes.

2. 2004 US Model BIT

The US Model BIT is also lengthy. Its main developments, compared to NAFTA Chapter 11 and previous BITs, consist of provisions that aim to clarify what

[219] James McIlroy, "Canada's New Foreign Investment Protection and Promotion Agreement - Two Steps Forward, One Step Back?" (2004) 5 J. World Invest. Trade. 4 at 631

[220] *Ibid.* at 644.

exactly is to be expected from the host country with regard to treatment of the foreign investor. In addition to the national treatment and MFN principles, in Articles 3 and 4 respectively, the Model also clarifies the meanings of "fair and equitable treatment" and "full protection and security." While the US Model BIT contains Article 13 which deals with recognizing and upholding the labour laws of the host country and the labour rights of its work force, the Canadian FIPA is silent on this matter. Transparency of arbitral proceedings is guaranteed by Article 29, while submissions of non-disputing parties are provided for in Article 28. The US Model BIT served as the basis for the negotiation of a BIT with the Republic of Uruguay, which entered into force on October 25, 2004.[221] The text of the BIT with Uruguay replicates that of the 2004 US Model BIT, with the exception of three annexes that contain general exceptions and reservations. Currently the US is negotiating a BIT with Pakistan.[222]

In spite of new developments and improvements that the Canadian and US Model BITs introduce, there is still much to be done in the area of extending their coverage and enhancing their protection. While BITs create and protect investors' rights, they lack "corresponding obligations on foreign investors or the home state of

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[221] The US BIT with Uruguay is pending Senate approval and its text can be found at <http://www.state.gov/documents/organization/38051.pdf> (accessed March 14, 2005).

[222] Office of the United State Trade Representative - United States, Pakistan Begin Bilateral Investment Treaty negotiations, online: Office of the United State Trade Representative <http://www.ustr.gov/Document_Library/Press_Releases/2004/September/United_States,_Pakistan_Begin_Bilateral_Investment_Treaty_negotiations.html > (accessed on March 14, 2005)

the foreign investor."[223] Also, the arbitration process in BITs seems to have been established with the sole intention of protecting only foreign investors. While it may be true that foreign investors operate in a much more vulnerable and precarious position than the host country in which they have established their investment, their activity may still be dangerous and harmful to the host state and its population, especially since sometimes their purposes may not be pure and the host country may lack the necessary institutions and regulatory framework for adequate protection.[224]

BITs extend the national treatment and MFN principles to foreign investors, as well as other important principles discussed above, arming them with additional rights to those they already enjoy in their home country. Thus, foreign investors are in a preferred position in the host country. However, in practice, domestic investors do not benefit much from BITs, since most of them provide for a virtual one-way flow of FDI from the developed country to the developing country. Plus, domestic investors are in a disadvantaged position because they cannot use the same BIT principles against their own government for actions that may unlawfully infringe their rights as investors, regardless of nationality.[225] They do not enjoy the same rights of protection against expropriation, performance requirements, etc, and, in general, their international arbitration recourses are quite limited.

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[223] *Supra* note 214 at 12.

[224] Mann, *supra* Chapter I, note 57 at 249-250.

[225] Maureen Appel Molot, "NAFTA Chapter 11: An Evolving Regime" NAFTA Chapter 11 Conference, online: NAFTA Chapter 11 Conference <http://www.carleton.ca/ctpl/chapter11/> at 6-7 (accessed on March 14, 2005).

Traditionally, BITs contain "do-not-do provisions", i.e. stipulations prohibiting host country governments from taking actions or measures that may result in negative effects on the operation of enterprises of foreign investors. It is time to think about including "to-do-provisions" in BITs, measures required to be taken by host countries in order to encourage and facilitate the flow of FDI in their territories and economies.[226] Host governments should be motivated and encouraged to shift from their laid back "do-nothing" position to a positive "do-something" position in which they would be actively involved in attracting FDI into their country. They should address the so-called "market failures" or those institutional deficiencies that cause harm in the same way to domestic and foreign investors, such as: currency fluctuations, an unstable inflation rate, and other monetary and fiscal policies.[227] Also, the protections afforded to foreign investors are extended only by public authorities although sometimes private hostile action may undermine the value of foreign investments.[228] Finally, BITs should refer to additional "house-keeping" measures that host countries sometime neglect to take upon themselves, such as the creation of and access to physical infrastructure, the establishment of official databases of rules and regulations, and the improvement of information flows.[229]

Many factors influence the decision of an investor to take the risk and invest in a foreign country rather than in its own. BITs may be improved and developed in

[226] *Supra* note 84 at 490.

[227] *Ibid.*

[228] *Supra* Chapter I, note 55 at 514.

[229] *Supra* note 84 at 490.

many other areas: economic, political and financial.[230] While this thesis is limited to the analysis of BITs from the legal point of view, it is obvious that other suggestions from other disciplines, e.g. economics, politics, etc, have their own value and influence on the future trends of BITs. In closing, the important thing to note is that the core purpose of BITs, as Vandevelde notes, is to increase prosperity in both the home country and the host country through foreign investment.[231] In order to achieve this noble purpose, all suggestions and ideas for future improvements of the BIT structure and provisions warrant the same interest and the same consideration.

e. Conclusions

Domestic laws are extremely important instruments for the encouragement of FDI. An investment law that is clear, up-to-date and comprehensive is a great incentive to attract foreign investors. Definitions of "investments" and "assets" should be as clear as possible and wide-ranging. Notification procedures and review procedures (in cases of compulsory review of certain investments) should be transparent, accurate, expedient and not too onerous in terms of restrictions. Banking laws should be modern and updated frequently to keep up with global developments, while banking institutions, because of their crucial role and indispensable effect on FDI, should play a major role in attracting much needed foreign investment.

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[230] See *supra* note 64 at 637-639 for many suggestions on how BITs may be improved to guarantee true economic liberalism.

[231] *Ibid. at* 627.

An independent and impartial judicial system is another incentive to attract foreign investors who may have to address these courts with their disputes at one time or another in the future. Countries which have justice institutions that radiate competence, lack of corruption and impartiality are attractive to foreign investors who cannot take all disputes to permanent or *ad hoc* international arbitration tribunals and who have to rely most of the time on domestic courts for the resolution of disputes.

BITs are instruments of FDI encouragement and protection. It is advisable that Albania and Croatia negotiate and sign numerous BITs with developed countries as well as among themselves. These BITs should contain the state-of-the-art principles and standards based on the models of NAFTA Chapter 11 and the newer Canadian Model FIPA and US Model BIT. Dispute resolution mechanisms in the form of *ad hoc* or institutional international arbitration tribunals should have an important place in these BITs, especially the investor-state arbitration procedures. Finally, future BITs should incorporate provisions that require a more interactive and participatory role on the part of the state institutions of the host country, so that host governments will be more like coaches and players, rather than mere laid-back spectators.

In the following chapter, I will focus on the economic and legal situation of the South East European countries of Albania and Croatia. After a short analysis of their common background and history during the Communist years, I will discuss their current economic situations, the state of affairs of FDI, their domestic legislation affecting FDI and BITs. I will follow with suggestions and ideas as to how Canadian legal principles and standards on FDI can be applied in the countries of Albania and Croatia for the advancement of the encouragement and protection of FDI in these nations.

CHAPTER IV

ALBANIA, CROATIA AND FDI

a. Common Communist background and history

Albania and Croatia (as one of the six republics of Yugoslavia) underwent the Calvary of Communism for almost half a century. While in general, their background and history under Communism is more or less the same, there are certain distinct features that set them apart even while they were part of the Eastern Bloc during the Cold War. The following section will analyze this background, focusing mainly on the characteristics of these individual countries. Initially, the case of the early breakthrough of Yugoslavia from the Communist Bloc soon after WWII in 1948 will be discussed and, then, the case of Albania which also severed its relationship with the Soviet Union in 1961 will be examined. The self-management style of Communist Yugoslavia will be discussed in more detail since it represents quite a different system of management from that of the rest of the Communist Bloc.[1]

Immediately after WWII, Communism spread as a much feared disease in South East Europe. The Red Army had assisted in the defeat of Bulgaria and Romania and the liberation of parts of Yugoslavia from Nazi occupation, which made

[1] Stephen L. Mueller & Srecko Goic, "Entrepreneurial Potential in Transition Economies: A View From Tomorrow's Leaders" (2002) 7 J. Dev. Entr. 399 at 400.

it easier for the native people to accept the political and economical guidance of the liberators.[2] There was a desire for political and economic changes in the heart of these people too.[3] In any case, by early 1945 the whole of Eastern Europe had fallen under the Soviet "sphere of influence."[4]

After the nationalization and the centralization of all kinds and forms of property in the hands of the state, the economies in all Eastern European countries were based on state-run five year plans, where every process and procedure was planned, authorized and supervised by the state, including wages of employees and prices of goods and services.[5] In the early years after WWII, the countries of Eastern Europe achieved rapid industrialization and impressive rates of growth; however, this was more the so-called 'extensive growth', described as "the massive mobilization of ever-increasing, but inefficiently used capital, labour, energy and raw material

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[2] The establishment of the Warsaw Treaty Organization in 1955 provided the legal justification for the prolonged deployment of these forces in the territories of Eastern Europe countries. See David Turnock, *Eastern Europe: An Economic and Political Geography* (London: Routledge, 1989) at 15.

[3] Bideleux & Jeffries, *supra* Chapter I, note 43 at 519.

[4] *Ibid.*

[5] Michael L. Burack, "American Private Direct Investment in Eastern Europe: Intersection of Business Interests and Foreign Policy" (1968-1969) 21 Stan. L. Rev. 877 at 898-899. See also *supra* Chapter I, note 10 at 112-114, and 113-114 for a detailed analysis on the structure and operation of the central planning agency, GOSPLAN, the Soviet prototype, which governed all economic activities in the Communist countries.

inputs," rather than the 'intensive growth' or "the more efficient use of resources."[6] The Council of Mutual Economic Assistance (CMEA), founded in 1949, aimed to assist in the synchronization of the national economic plans of all its various Communist members.[7] The CMEA based its operation more on the sense of solidarity and "brotherly" support than on real economic logic or cost-effective planning.[8] Consequently, most of the trade of Eastern European countries was among themselves.[9] The level of trade within the CMEA accounted for only 4 percent of world trade in 1989.[10]

In such circumstances of extreme economic and political supervision and guidance, and under the constant threat of the Soviet military,[11] it was only a matter of time until the emergence of rifts and breakups. Yugoslavia was the first country to

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[6] This process of industrialization and growth is sometimes described as a "slash and burn" economy. See Bideleux & Jeffries, *supra* Chapter I, note 43 at 529.

[7] Richard F. Staar, *Communist Regimes in Eastern Europe*, 5th ed. (Stanford: Hoover Institution Press, 1988) at 291.

[8] Several initiatives of the CMEA can be mentioned, the most important being the Friendship oil pipeline, the Peace electric power distribution system, the Brotherhood natural gas pipeline, the pooling of railroad freight cars, the network of expressways, two CMEA banks and the Intermetal steel community. *Ibid.* at 297.

[9] For example, trade within CMEA accounted for 80% of Bulgarian exports and imports in 1976. *Ibid.* at 51.

[10] Bideleux & Jeffries, *supra* Chapter I, note 43 at 565.

[11] The incidents of the student revolts in Poland in 1968 and the invasion of Czechoslovakia the same year by the Warsaw Pact seriously discouraged even the most staunch optimists. *Ibid.* at 529.

abandon the Soviet Union's sphere of influence in 1948.[12] Subsequently, Yugoslavia maintained relations with Western countries that were much more open than the rest of the Communist countries. Since 1963, Yugoslav nationals were free to immigrate and work in the West.[13] The reforms of 1965 provided for more decentralization of economic and political power and private enterprises were also allowed.[14] Regardless of these measures, in the late 1980s, Yugoslavia was in recession for both economic and political reasons as well as the difficult cultural relationship among the different nationalities that had been forced to cohabit in an artificial entity, mainly Slovenians, Croatians, Bosnians, Serbs and Albanians.[15] After the collapse of Communism, these contradictions within Yugoslavia exploded in the destructive ethnic conflicts of 1991-1995, initially in Slovenia and then in Croatia and Bosnia-Herzegovina,[16] that led to the disintegration of Yugoslavia.

In contrast, Albania broke all political and economic relations with the Soviet Union in 1961, mainly because of the Soviet Union's intention to deviate from Stalin's course of actions, which was considered "treason" by the Albanian Communist Party.[17] The need for economic and ideological support[18] made Albania

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[12] *Supra* Chapter I, note 10 at 145-146.

[13] *Ibid.* at 348.

[14] *Supra* note 2 at 153.

[15] *Supra* Chapter I, note 10 at 339.

[16] *Supra* Chapter I, note 50 at 29.

[17] Stavro Skendi, "Albania and the Sino-Soviet Conflict" (1961-1962) 40 Foreign Aff. 471 at 471, 473.

turn to the other Communist superpower of the time, the People's Republic of China,[19] with which it had established good relations even before its break-up with the Soviet Union,[20] and whose stance against the Soviet Union Albania had long supported.[21] However, this strange economic relationship was not destined to last, with the first cracks appearing in 1971 as China moved toward closer relations with the US.[22] By 1978, Albania found itself again in total isolation and destitution,[23] unseen in other communist countries, when everything, even economic survival was to be sacrificed in the name of national sovereignty.[24] While being in a state of war (at least technically) with its southern neighbor, Greece,[25] and distrustful of its Northern neighbor, Yugoslavia, since early after the end of WWII,[26] Albania tried to

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[18] Andrew Hammond, ed., *The Balkans and the West – Constructing the European Other, 1945-2003* (Hampshire: Ashgate Publishing Limited, 2004) at 129.

[19] *Supra* Chapter I, note 10 at 378.

[20] Since 1958 Albania had started to move away from its close relationship with the Soviet Union and approach Communist China. *Supra* note 17 at 473.

[21] Paulin Kola, *The Search for Greater Albania* (London: C. Hurst & Co., 2003) at 124.

[22] *Ibid.* at 146.

[23] *Supra* Chapter I, note 10 at 378.

[24] Miranda Vickers, *The Albanians – A Modern History* (London and New York: I.B. Tauris Publishers, 1999) at 203.

[25] The state of war between Albania and Greece ended in 1987, with the re-establishment of diplomatic relations. *Ibid.* at 379-380.

[26] Skendi gives a reason for the paranoid feeling of Albania toward its neighbors: "The territory of Albania has been coveted by its neighbors for so long that the Albanian people have grown suspicious of all of them." See *supra* note 17 at 477; see also *supra* note 21 at 94.

improve its economic relationship with some Western European countries with which it had maintained weak cultural relations during the "engagement" with the Soviet Union[27] and in later years.[28] However, no laws to encourage FDI or to relax the hold of the Communist regime over economic development were adopted in Albania.[29] As a result, because of the weak economic position of Albania in the global ambit of trade affairs, it remained the poorest and the least-developed country in Eastern Europe[30] until the collapse of its Communist totalitarian regime in 1991. While the collapse of Communism in Albania was not followed by an all-out war like in Croatia and other parts of Yugoslavia, it had its violent and troubling consequences for the general Albanian population.[31]

The case of the economic development of Yugoslavia after severing its relations with the Soviet Union is quite different from that of the other South East European countries. Yugoslavia once was the forerunner among South East European countries with regard to the openness of its economy to Western trade and investment and its reforms leading to decentralization and liberalization of state

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[27] For example, a US $ 8 million trade agreement was signed with Italy in December 1961. See *supra* note 17 at 478.

[28] *Supra* note 24 at 193.

[29] *Ibid.* at 203.

[30] In 1989, 10.7 percent of the work force in Albania was unemployed. This figure hit 39 percent in 1992. See Bideleux & Jeffries, *supra* Chapter I, note 43 at 578.

[31] See *infra* text accompanying notes 58 to 62.

control of the activities of enterprises.[32] After abandoning the Soviet Union sphere of influence in 1948, Yugoslavia made several attempts to streamline its economy, make itself an attractive location for foreign investors and, most important, set itself apart from the rest of the countries of the Communist Bloc. Liberalization reforms began in 1963 with the freedom of movement of workers to find jobs in Western Europe.[33] Then, the reforms of 1965 provided for more decentralization of economic and political power, and private enterprises were also allowed.[34] In 1967, Yugoslavia became the first Communist country to extend a "general invitation to foreign investors".[35] Enterprises in Yugoslavia were somewhat independent of the state planner's order and operated to direct their activities according to market performance.[36] Yugoslavia was not willing to give up its Marxist ideological system but, at the same time, it realized the dire need for technological improvement and foreign capital.[37] Subsequently, it approved a series of laws that provided for a certain compromise between "market socialism" and incentives for attracting foreign investors.[38] Yugoslavia's original foreign investment legislation was adopted in

[32] Mihajlo M. Acimovic & Stephen M. Weiner, "Economic Crimes in Yugoslavia" (1971-1972) 13 B. C. Indus. & Com. L. Rev. 1331 at 1335.

[33] *Supra* Chapter I, note 10 at 348.

[34] *Supra* note 2 at 153.

[35] Peter B. Maggs & Milan Smiljanic, "Investment in Yugoslavia and Eastern Europe" (1969) 4 J.L. & Econ. Dev. 1 at 1.

[36] *Ibid.* at 3.

[37] Timothy P. Neumann, "Joint Ventures in Yugoslavia: 1971 Amendments to Foreign Investment Laws" (1973) 6 N.Y.U. J. Int'l L. & Pol. 271 at 275.

[38] *Ibid.*

1967,[39] with several amendments in 1978.[40] The preferred form of foreign investment in Yugoslavia (and the only one allowed) was the joint-venture, but a hybrid version which included several restrictions.[41] The legislation specified that the foreign investor's share of the joint-venture could not exceed 50 percent.[42] The investor did not become owner of this share since the ownership of the property was social.[43] Other limitations imposed on foreign investors included the requirement for approval by the Federal Secretariat for the Economy,[44] as well as restrictions on repatriation of income and capital.[45] All these factors, accompanied by the general sense of distrust related to socialist countries prevalent among Western investors, rendered futile these attempts by Yugoslavia to improve its technology and economy.

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[39] See Petru Buzescu, "Joint-Ventures in Eastern Europe" (1984) 32 Am. J. Comp. L. 407 at 408. The following is a list of laws adopted in 1967 for the purpose of encouraging FDI in Yugoslavia: Law on the Profit Tax Payable by Foreign Persons Who Invest Funds in a Domestic Business Organization for Joint Business Operations, Official Gazette No. 31 (1967); the Law Amending and Supplementing the Basic Law on the Enterprises, Official Gazette No. 31 (1967); the Law Amending and Supplementing the Law on Assets of Economic Organizations, Official Gazette No. 31 (1967).

[40] Law on Investment of Foreign Persons' Capital in Domestic Organizations of Associated Labor, 18 I. L. M. 230 (1979).

[41] Mirodrag Sukijakovic, "Legal Aspects of Foreign Investment in Yugoslavia" (1972) 37 Law & Contemp. Probs. 474 at 475.

[42] *Supra* note 35 at 5.

[43] *Supra* note 37 at 296.

[44] The Law Amending and Supplementing the Law on Assets of Economic Organizations, Official Gazette No. 31 (1967), Article 64, paragraph 1. See *supra* note 35 at 4.

[45] The Law Amending and Supplementing the Law on Assets of Economic Organizations, Official Gazette No. 31 (1967), Article 64, paragraph 1. *Ibid.* at 6-7.

From the political standpoint, Yugoslavia in the late 1970s was already in a "delicate balance".[46] Yugoslavia was a federal state made up of six republics and two autonomous regions.[47] Differences in religion (Catholic Slovenes and Croats; Orthodox Serbs, Montenegrins and Macedonians; and Muslim Bosnians and Albanians in Kosovo), along with differences in standards of living and income, created disagreements and tensions.[48] Minorities in Yugoslavia had always been misused and abused based on the political agendas of neighboring countries.[49] These tensions increased until they exploded in the late 1980s and early 1990s, giving way to the violent and bloody breakdown of Yugoslavia's republics.

While it is not the goal of this thesis to analyze the rationale and the motives that caused the disintegration of Yugoslavia, it is worth mentioning that "Yugo-socialism"[50] failed in two aspects: the economic aspect and the political aspect.[51] The

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[46] David A. Andelman, "Yugoslavia: The Delicate Balance" (1979-1980) 58 Foreign Aff. 835.

[47] *Supra* Chapter I, note 42.

[48] *Supra* note 46 at 839. As the Economist put it: "The people of the Balkans are fired by hatreds that go back centuries. Roman Catholics have been fighting Orthodox Christians there since 1221; Serbs remember their defeat at the hands of the Turks in 1389 as though it were yesterday. Though the tribes are intermingled, and sometimes intermarried, the intensity of ethnic and religious rivalry has not diminished, nor has the ferocity with which it is expressed." See "Into Bosnia" *The Economist* (July 4, 1992) at 14.

[49] Andelman, *ibid.* at 840.

[50] Kenneth Anderson, "Illiberal Tolerance: An Essay on the Fall of Yugoslavia and the Rise of Multiculturalism in the United States" (1992-1993) 33 Va. J. Int'l L. 385 at 406.

[51] *Ibid.*

republics, despite their disputes and tensions, could have lived peacefully in a situation of economic stability; yet its absence amplified these contradictions.[52] The different political treatment of the "Belgrade Eight" and "Croatian Spring" (two academic groups whose ideology was considered contrary to that of the government) in the late 1970s and early 1980s underlined the political preferences of the Serb-dominated federal authorities.[53]

b. Albania and Croatia after the collapse of Communism

In the post-Communist period, the South East European countries realized immediately that democracy offers more opportunities than Communism for attracting and maintaining FDI.[54] Thus, very soon after the collapse of Communism in the early 1990s, they began their long march on the path toward democracy, what Bideleux and Jeffries call an "arduous 'triple transition': from communist dictatorship to pluralistic democracy, from centrally administered to market economies, and from Soviet imperial hegemony to fully independent nation-statehood."[55] In this process,

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[52] *Ibid.*

[53] While members of "Belgrade Eight" were only removed from their teaching positions at the University of Belgrade, their counterparts in "Croatian Spring" were sentenced to long prison terms. See *supra* note 50 at 414-415. For more arguments on the background and motives of the break-up of Yugoslavia, see Svetozar Stojanovic, "The Destruction of Yugoslavia (1995-1996) 19 Fordham Int'l L.J. 337 at 339-341.

[54] Wierzbowski, *supra* Chapter III, note 116.

[55] Bideleux & Jeffries, *supra* Chapter I, note 43 at 590.

through trial and error, these countries have aimed to establish the legal framework for the new political and economic systems, a process that still continues with its ups and downs. Foreign investment laws are among the most important laws a government can approve which significantly affect FDI as such legislation can either promote or discourage FDI depending on the purposes of the enacting and implementing authorities.[56]

1. Albania

Albania's efforts to get rid of its Communist regime began in late 1990 and culminated successfully in March 1992, when the newly-formed Democratic Party of the opposition won 62 percent of the votes in the general election.[57] This period of disintegration of the state, especially in 1991, uncovered the true state of dreadful conditions in Communist Albania and triggered a violent transition.[58] Annual inflation in 1991 was almost 600 percent and the level of unemployment 25 percent, with many basic food shortages.[59] Albanians infuriated by the Communist abuse and the disastrous early years of transition (1991-1992) turned their rage upon the state institutions and government authorities. Schools, health centers and public property

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[56] Carlson, *supra* Chapter I, note 7.

[57] Miranda Vickers & James Pettifer, *Albania – From Anarchy to a Balkan Identity* (New York: New York University Press, 2000) at 78.

[58] *Ibid.* at 72-73.

[59] *Supra* note 21 at 202. In a now famous quote the Prime Minister of Albania Ylli Bufi at the time declared that the food supplies of the country would last only six days, *supra* note 21 at 205.

in general were widely damaged and looted.[60] Organized crime and illegal activities began to flourish, especially in southern Albania, partly because of its proximity to the Italian coast.[61] Public land was taken away from the legal owners and occupied unlawfully,[62] and subsequent governments ignored this situation for years. Today, land ownership is certainly one the greatest problems in Albania and also one of the main obstacles for increasing FDI and the development of the country.

The new "democratic" government immediately turned into a semi-authoritarian regime (much as in the case of Croatia). Political and economic power was concentrated in the hands of very few people, and those who disagreed with them were either dismissed or jailed.[63] The privatization process was very slow because of disagreements over ownership of companies.[64] Conflicts with neighboring Greece

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[60] Tom Gallagher, *The Balkans After the Cold War: From Tyranny to Tragedy* (London: Routledge, 2003) at 22.

[61] *Supra* note 57 at 7.

[62] Gloria La Cava & Rafaella Y. Nanetti, *Albania – Filling the Vulnerability Gap* (Washington, D.C. – The International Bank for Reconstruction and Development 2000) at 20.

[63] *Supra* note 21 at 324-326. In 1994, the leader of the Democratic Party was dismissed because of disagreements with the President of Albania (who was also a co-founder of the Democratic Party); the leader of the opposition was jailed in 1994 (only to be released in 1997); and, the head of the Supreme Court was dismissed by the Parliament of a Democratic Party majority in 1995. The former Prime Minister of Albania in 1991 was jailed in 1993 and served two years for alleged embezzlement of government funds. See also *supra* note 57 at 240.

[64] Kola, *ibid.* at 283.

over minority issues did not help to improve the situation.[65] Elections in 1996 were neither fair nor free, and leaders of the opposition who protested publicly against the rigged vote were beaten by the police.[66] The collapse of pyramid schemes and the following armed riots in 1997 took away almost US $ 1.2 billion of Albanian savings, as well as its state institutions, relative stability and all economic progress up to that time.[67] Since then, Albania has generally lacked the political stability necessary for economic development. A failed *coup d'état* in 1998,[68] the Kosovo war crisis in 1999[69] and the local elections tensions in 2000[70] have proven once again the fragility of the Albanian economy.

From the legal point of view, Albania entered its transition period by adopting a series of laws which were meant to facilitate its transition to a free market economy and to attract foreign investors. Albania adopted the law "On Commercial

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[65] *Ibid.* at 311.

[66] *Supra* note 57 at 283.

[67] *Supra* note 24 at 244-247.

[68] Geoffrey Pridham & Tom Gallagher, eds., *Experimenting with Democracy: Regime Change in the Balkans* (London: Routledge, 2000) at 43.

[69] More than 440,000 refugees from Kosovo sought shelter in Albania during March-June 1999. See Organization for Security and Cooperation in Europe, *Kosovo/Kosova: As Seen, As Told: An Analysis of the Human Rights Finding of the OSCE Kosovo Verification Mission* (Warsaw: Office for Democratic Institutions and Human Rights, 1999) at 99.

[70] Human Rights Watch – Albania, Human Rights Development, online: Human Rights Watch <http://www.hrw.org/wr2k1/europe/albania.html> (accessed March 14, 2005).

Companies" in late 1992,[71] which is the main law governing the types of companies allowed to be formed in Albania. These include partnerships, limited partnerships, limited liability companies and joint stock companies.[72] This piece of legislation was followed by the law "On the Business Register" enacted in early 1993,[73] providing the rules for the registration of companies established under the above-mentioned act.

The law "On Sanctioning and Protecting Private Property, Free Initiative and Privatisation" of 1991 was the basic law governing privatization in Albania.[74] This was the first Albanian law that enabled the privatization of the state-run enterprises, mainly those of a small size. This law did not permit foreigners to participate in the privatization process, a drawback that was corrected in 1992.[75] Initially, privatization was expected to be concluded in a very short time. In 1994, privatization was expected to be completed by 1996.[76] However, as a result of nepotism and political favoritism, the privatization process progressed very slowly.[77]

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[71] Law No. 7638, dated November 19, 1992, Official Gazette No. 8. See Ministry of Economy, *Company Registration* (Tirana: Ministry of Economy, 2004) at 4.

[72] *Ibid.* at Article 2.

[73] Law No. 7667, dated January 1, 1993, Official Gazette No. 1.

[74] Law No. 7512, dated August 10, 1991, Official Gazette No. 6. See also Albanian Economic Development Agency (AEDA), Strategy of Privatization – Basic Legal Frame, online: AEDA <http://aeda.gov.al/privatization.htm> (accessed March 14, 2005).

[75] Law No. 7653, dated December 23, 1992, Official Gazette No. 10. Ibid.

[76] Mike Shallcross, "Europe's Fastest Growing Location" *Corporate Location* (November/December 1994) 24 at 25.

[77] *Supra* note 68 at 136. Only twenty companies were privatized in 1995 and fifty more in 1996.

The law "On the Transformation of State Enterprises into Commercial Companies",[78] of 1995, amended in 1997,[79] serves as the main law on privatization in Albania of large state-run companies. The voucher scheme, provided by this Act for privatization, in which citizens were given a specific amount of credit in vouchers to be used toward purchasing shares in state-run enterprises being privatized, failed because of the skepticism of the public and the lack of proper preparation and information for this delicate and important process.[80] The civil unrest of 1997-1998 and the following crisis in Kosovo in 1999 have had their impact on the privatization process too, as in all areas of the economy.[81] Today, the government is trying to conclude the privatization of large companies, as most small and medium-sized enterprises have largely been privatized.[82]

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[78] Law No. 7926, dated April 20, 1995, Official Gazette No. 11.

[79] Law no. 8237, dated September 1, 1997, Official Gazette No 13. A series of laws followed regarding specific areas of economy and industry as they underwent the process of mass privatization, i.e. the law "On the Privatization of the Electrical Power Sector", No. 7963, dated July 13, 1995, Official Gazette No. 17; the law "On the Privatization of the Commercial Companies of the Mining Sector", No. 8026, dated September 11, 1995, Official Gazette No. 24.

[80] *Supra* note 68 at 136. *Ibid.*

[81] *Supra* note 24 at 244-247. See also *supra* note 69 at 99.

[82] European Bank for Reconstruction and Development, *Strategy for Albania* (London: European Bank for Reconstruction and Development, 2004) at 1.

i. Albania's Investment Law

With regard to FDI, Albania enacted its first investment law, "On Foreign Investments" in 1992.[83] The law required that all foreign investments in Albania be reviewed by various branches of government, depending on the size of the investment.[84] While the law did not provide for any specific restriction on foreign investment, it contained the possibility that such restriction might still be imposed under certain conditions.[85] National treatment was guaranteed by Article 8, and other principles and standards were guaranteed by other provisions of the law. However, restrictions remained with regard to employment of local staff (Article 19), transfer of funds and profits (Article 12), as well as expropriation (Article 9).

The 1992 Law was revised in order to add clarity and encourage foreign investors and a new version was adopted in 1993.[86] Article 1 of the 1993 Law is very extensive in its coverage of both the "investor" and "investment" definitions, even comparable to the 2004 Canadian Model FIPA.[87] In Article 2(1) we find the national

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[83] Law No. 7594, August 4, 1992, Official Gazette No. 4 (hereinafter 1992 Law).

[84] Article 3 of the 1992 Law. See Carlson, *supra* Chapter I, note 7 at 586.

[85] Article 2 of the 1992 Law states that foreign investments will be prohibited if they compromise Albania's national defense, public order, health, environment, or morals. See Carlson, *supra* Chapter I, note 7 at 586.

[86] Law No. 7764, November 2, 1993, Official Gazette No. 13 (hereinafter 1993 Law) - reprinted in Appendix A.

[87] Compare to Article 1 of the 2004 Canadian Model FIPA, *supra* Chapter III, note 82.

treatment principle, which applies to all FDI in Albania, with the exception of land ownership.[88] This article also removed the existing requirements for authorization of the admission of FDI provided in the 1992 Law. Arguably the MFN principle could be extracted from Article 2(2). However, this article does not now reflect any of the terms or customary language of international treaties related to provisions on the MFN principle. Even the term "MFN" is not expressly mentioned anywhere in this article or in the rest of the provisions of the 1993 Law. The minimum standard of treatment principle is provided in Article 2(3).

Performance requirements related to employment of foreign citizens are prohibited in Article 3, while Articles 4 and 5 deal with expropriation, nationalization and compensation. While expropriation and nationalization will still be allowed – under certain limited circumstances – Article 4 provides for the well-known formula of "prompt, adequate and effective" compensation whenever these circumstances may be encountered.[89] The 1993 Law also eliminates other restrictions related to transfers of profits or repatriation of capital, pursuant to Article 7.

In the area of arbitration, the 1993 Law is also more advanced as it provides that arbitration may be used for disputes between the foreign investor and the Albanian government, as well as for disputes between the foreign investor and private

[88] Albania is a very small country in terms of land mass, therefore the Albanian government has determined it appropriate to limit land ownership by foreign investors. For conditions when land ownership is allowed for foreign investors see *infra*, text accompanying note 136.

[89] Carlson, *supra* Chapter I, note 7 at 592.

Albanian parties or state enterprises.[90] However, if there are no previous agreements on the settlement of disputes, the arbitration may be carried out only in the Republic of Albania and in compliance with its domestic legislation, pursuant to Article 8(1). The exception to this rule is for those investment disputes that are related to expropriation, compensation for expropriation, discrimination or transfers, where the ICSID arbitration mechanism is allowed to be used.[91] Therefore, the freedom of foreign investors to choose institutions and venues for the arbitration of potential investment disputes is unlimited during the period prior to the dispute. After the dispute has materialized, foreign investors are quite limited with regard to the means at their disposal for resolving their investment disagreements.

Article 9 provides an interesting clause which serves as a safeguard provision. It states that international agreements ratified by Albania that provide more rights or greater protection for foreign investors will have superiority over the investment law. While this provision may allow foreign investors to breathe a sigh of relief, it is important to note that few investors would be interested in tracking down all international agreements signed by Albania in order to find exactly what rights and protection are provided for their investment. Ratified international agreements, while at a higher level in the hierarchy of laws in Albania than domestic legislation,[92] do not get the same exposure as domestic laws in legal literature, education or practice.

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[90] 1993 Law, Article 8. *Ibid.* at 593.

[91] 1993 Law, Article 8(2). Albania became a signatory state to the ICSID Convention in 1991.

[92] Albanian Constitution (1998), Article 116(1)(b).

Finally, Article 10, while it serves a noble purpose of guaranteeing the adoption of measures to ensure national security, public order, preservation of peace and defense interests, it does not provide clarifications on what is expected to be construed as "necessary measures" for achieving the foregoing goals and does not refer to other domestic legislation or international agreements that may assist in reaching these clarifications. The 1993 law was very advanced compared to other countries in the region at the time when it was enacted,[93] putting Albania in the vanguard with regard to legislation to attract and protect FDI.

These laws, along with other legislation adopted by the new governments, achieved a certain positive development from the economic and investment point of view.[94] In 1993, Albania was the fastest growing country in Europe with a recorded Gross Domestic Product (GDP) of 11 percent.[95] The same "miracle" was repeated again in 1995.[96] Coca-Cola was among the first foreign investors to set up shop in Albania by building a factory which is still in operation and symbolically is a sign of

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[93] Carlson, *supra* Chapter I, note 7 at 596.

[94] Other laws related to FDI include Law "On Property Tax", No. 7805, dated March 16,1994, Official Gazette No. 3, the Law "On Profit Tax", No. 7677, dated March 3, 1993, Official Gazette No. 3 and, the Law "On Buying and Selling Building Sites" No. 7980, dated July 27, 1995, Official Gazette No. 18.

[95] *Supra* note 76 at 24.

[96] *Supra* note 68 at 145.

encouragement to other foreign investors.[97] However, the major obstacles to FDI at the time were considered the "inadequate infrastructure and poorly developed banking system."[98] Also, several authors attribute this economic growth to the low level of economic development in the past,[99] foreign aid and remittances from Albanians working abroad, as well as the flourishing of illegal activities, such as the smuggling of oil to Yugoslavia in violation of the UN-imposed embargo from Northern Albania, and Mafia-like activities, such as merchandise and human trafficking to Italy through Southern Albania.[100]

Albania was also very active in negotiating and signing 29 BITs with neighboring countries and with industrialized countries in Western Europe and the rest of the world.[101] More recently, Albania turned its attention to negotiating FTAs and signed several such treaties, mainly with other countries in the region.[102] The

[97] A Coca-Cola bottling plant of a value of US$ 9.5 million was built on the outskirts of Tirana, the capital of Albania, in 1993. Filanto, an Italian shoe manufacturer, build a factory in 1993 and in 1994 it employed almost 4,000 people. See *supra* note 76 at 24.

[98] *Ibid.*

[99] *Supra* note 60 at 185-186.

[100] *Supra* note 68 at 242-243.

[101] For a complete list of BITs that Albania has signed see UNCTAD – Investment Instruments Online, Bilateral Investment Treaties, online: UNCTAD <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (accessed March 14, 2005).

[102] Some of these countries include Croatia, Romania and Bulgaria. See Ministry of Economy of Albania: Ministry of Economy – "Forumi i Tregtisë së Lirë", online: Ministry of Economy <http://www.minek.gov.al/FT_Forum/Regional_Trade_Developments_al.pdf>For a complete list of

majority of these BITs contain only the basic FDI standards and principles, much like the Canadian FIPAs of the pre-NAFTA period,[103] such as the national treatment principle,[104] most-favored nation principle,[105] provisions against expropriation,[106] compensation for losses,[107] prohibition of performance requirements and arbitration of investment disputes.[108] The influence of NAFTA may be seen on Albania's BIT with the US as it provides for arbitration of disputes, even those between the host government (i.e. Albania) and a national or company of the other party (i.e. the US). This is also the most detailed Albanian BIT to date. Albania has not negotiated or signed a BIT with Canada.

ii. The banking system in Albania

The Albanian banking system began to be regulated in 1992 through the enactment of the law "On Banking."[109] This law was later amended in 1996[110] and

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FTA that Albania has signed see Ministry of Economy of Albania: Ministry of Economy – "Forumi i Tregtisë së Lirë", online: Ministry of Economy <http://www.minek.gov.al/FT_Forum/Regional_Trade_Developments_al.pdf> (accessed March 14, 2005).

[103] See Albanian BIT with Germany (1991), which is only 6 pages and contains only 12 articles.

[104] See Albanian BIT with Greece (1991), Article 3.

[105] See Albanian BIT with Italy (1991), Article 3.

[106] See Albanian BIT with Croatia (1993), Article 4.

[107] See Albanian BIT with the UK (1994), Article 4.

[108] See Albanian BIT with the US (1995), Article VI and Article IX.

[109] Law No. 7559, dated April 22, 1992, Official Gazette No. 3.

1998.[111] At the time of adoption of the first law in 1992, there were only four banks in Albania, all state-run.[112] This number grew to nine in 1998[113] and today there are 15 banks in Albania, most of them composed of 100 percent foreign capital.[114] Albania still has a cash-culture as most transactions in Albania are performed in cash.[115] Therefore, banks are quite limited in the range of services that they offer given the preferences of their clients. Credit transfers take longer than in Western countries and most banks either do not provide loans to businesses or do so under a system of very complex regulations, which limits considerably the number of potential clients.[116] In addition, the pyramid crises of 1997 have crushed the confidence of depositors. Recently, the government sold the Savings Bank of

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[110] Law No. 8075, dated February 22, 1996, Official Gazette No. 5.

[111] Today, the banking system is regulated by the Law "On the Bank of Albania" No. 8269, dated December 23, 1997, Official Gazette No. 21, as amended by the Law No. 8365, dated July 2, 1998, Official Gazette No. 15. See Ministry of Economy, *An Investor's Guide to Albania* (Tirana: Ministry of Economy, 2004) at 58.

[112] Public Private Finance Institute: Elida Reci, "Sistemi Bankar ne Shqiperi – Zhvillimet e Deritanishme dhe Perspektiva per te Ardhmen", online: Public Private Finance Institute <http://www.alb-ppfi.org/about.htm> (accessed March 14, 2005) [translated by author].

[113] Albanian Economic Development Agency (AEDA), Banking System, online: AEDA <http://aeda.gov.al/banking.htm> (accessed March 14, 2005).

[114] See *supra* note 111 at 32.

[115] United States of America, Department of Commerce – U.S. Commercial Service, online: U.S. Commercial Service, Albanian's Investment Climate Statement: 2005 <http://www.buyusainfo.net/docs/x_7135247.pdf> at 1 (accessed March 14, 2005).

[116] "The banks that don't lend" *The Economist* 359:8219 (28 April 2001) 77 at 77.

Albania (which is the main bank in Albania, performing more than 60 percent of the banking activity in the country) to an Austrian bank,[117] which is expected to improve banking services in Albania.

iii. The IP laws in Albania

With regard to IP, Albania adopted extensive domestic legislation on protection of IP in the early years of transition, guaranteeing all rights of IP owners.[118] Also, Albania became a contracting party to the main international treaties on protection of IP.[119] However, as it is the case with most enacted laws in Albania, there was and continues to be, a discrepancy between the legislation and its implementation.[120] Until the end of 2003, pirated DVDs and CDs were being aired on Albanian private TV and radio stations. Today, a large abundance of these illegally copyrighted materials may still be easily bought or rented in most cities in Albania.[121]

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[117] "Albania: Divided We Stand" *Business Eastern Europe* (29 March 2004) 7 at 7.

[118] The law "On Industrial Property", No. 7819, dated April 27, 1994, Official Gazette No. 6, as amended by the law No. 8477, dated April 22, 1999, Official Gazette No. 17, the law "On Copyright", No. 7564, dated May 19, 1992, Official Gazette No. 3, as amended by the law No. 7923, dated April 19, 1995, Official Gazette No. 11, by the law No. 8594, dated April 6, 2000, Official Gazette No. 9 and, by the law No. 8630, dated July 3, 2000, Official Gazette No. 21.

[119] Albania became a contracting party to the Berne Convention in 1994; the Paris Convention in 1995 and the WTO TRIPs agreement in 2000. See *supra* note 111 at 58.

[120] *Supra* note 115 at 8-9.

[121] *Ibid.*

iv. The fall of Albania's "democratic" regime

Even though Albania had adopted a substantial number of domestic laws and international treaties, the state was far from being established. The problem was that Albanians, tormented and impoverished by half a century of Communism, misunderstood democracy to mean lawlessness. Further, the government did not do much to change this perception of the people. In the words of Gashi:

> [E]veryone was free to enrich themselves as quickly as possible. No taxes flowed into the state budget; civil servants and the police were directly dependent on bribes from businessmen; the rule of law had almost no meaning; there was no official state employment; individual capital was larger than the fiscal resources of the state; and no one believed in the helping hand of the state. ...Albanian society has many similarities with a poorly raised and abused child.[122]

Albanians started to invest in pyramid schemes in the early 1990s. "At the end of 1996, there were approximately two billion US dollars invested in the pyramid schemes, several times the size of the government budget."[123] Both the government and the opposition, allegedly benefiting financially and with the hope of capitalizing on the unavoidable collapse of the pyramid schemes, did nothing to stop or curb the flow of this "mass madness", despite repetitive warnings by the WB and the IMF

[122] Dardan Gashi, "Myth, Wild Capitalism and Democracy in Albania" (1998) 22 Fletcher F. World Aff. 29 at 29, 32.

[123] Vickers, *supra* note 24 at 244. While it may difficult to assess the beginning and the extent of the pyramid schemes phenomenon in Albania, Vickers asserts that "[a]lmost every Albanian family had invested money in one pyramid scheme or another."

starting in October 1996.[124] The collapse of the pyramid schemes beginning in December 1996 triggered the civil unrest and rebellion that engulfed Albania in the spring of 1997.[125] State institutions melted overnight and Albanians survived anarchy, mayhem and paranoia for almost four months until the new elections in July 1997.[126] At this time, all the little progress that had been achieved was erased completely, and the establishment of free market economy had to start from over again the beginning, with 1997 considered to be the "year zero."

v. Albania post-1997

In 1997, while the new government began its efforts to re-establish state institutions and revive the economy, the crisis in Kosovo, Yugoslavia escalated. The eruption of the three-month NATO campaign against Serbian forces in Yugoslavia triggered an exodus of almost one million refugees – according to some accounts more than 500,000 Albanians from Kosovo were deported during the conflict, arriving and staying in shelters in Albania.[127] This, of course, exhausted the insufficient resources of the government, dealing another blow to the recovery attempts of the Albanian state. The instability of the region, even after the conflict of

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[124] Vickers, *ibid.* at 245.

[125] See UNCTAD, UNCTAD WID Country Profile: Albania (New York and Geneva: United Nations, 2002) at 1.

[126] *Supra* note 122 at 35.

[127] Mariella Pandolfi, "Contract of Mutual (In)Difference: Governance and the Humanitarian Apparatus in Contemporary Albania and Kosovo" (2003) 10 Ind. J. Global Legal Stud. 369 at 378.

1991-1995 in Yugoslavia, the war in Kosovo in 1999 and the collapse of the Milosevic regime in 2000, hampered Albania's efforts to attract the much-needed FDI.

During recent years, Albania has redoubled its efforts and seems to have attained several positive results in attracting FDI and improving the economic standard of living in the country.[128] Still, large and important sectors of the economy remain under poor state management and are slated for privatization in 2005.[129] The Albanian government has taken steps to attract FDI and to promote Albania as a FDI-friendly country with a favorable climate for foreign investments by establishing the Albanian Economic Development Agency (AEDA)[130] in August 1998 and the Albanian Foreign Investment Promotion Agency (ANIH)[131] in April 2002. The UNCTAD World Investment Report of 2004 lists Albania among the countries that have shown a high FDI performance (in attracting foreign investments) way above its low FDI potential during 2000-2002.[132]

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[128] See *infra* text accompanying notes 133 to 134.

[129] The state telecommunication monopoly Albtelecom, the oil refinery and oil products distributor ARMO, the power utility KESH, insurer INSIG and oil extraction company Albpetrol are expected to be privatized through international tenders in 2005. See "Country Risk Summary: ALBANIA," *Emerging Europe Monitor* 11:10 (October 2004) at 1.

[130] For more information see the official website of AEDA at <http://www.aeda.gov.al> (in English) (accessed January 14, 2005).

[131] For more information see the official website of ANIH at <http://www. http://anih.com.al> (in English) (accessed January 14, 2005)

[132] *Supra* Chapter II, note 120 at 17.

Today, FDI in Albania has increased sharply, almost five hundred percent higher compared to 1994, and Albania's main trade partners are the EU countries of Italy and Greece.[133] Economic conditions have improved considerably. Inflation in December 2004 was only 2.2 percent, while the annual inflation for that year was 2.9 percent.[134] However, there are still many drawbacks to investing in Albania. The infrastructure is underdeveloped, public utilities in general are unreliable, there is a weak judicial system and there are competing claims of property ownership and corruption.[135] There are no fiscal or financial incentives for foreign investors.[136] Albania, in its 1993 Investment Law and in BITs, agrees that no performance requirements shall be adopted against foreign investors, but in practice there is an important exception related to foreign persons purchasing commercial property. Foreigners are only permitted to purchase commercial property if the value of the property constructed exceeds three times that of the purchase price of the land.[137]

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[133] In 1994, FDI was at just US $64.9 million, while in 2004 it reached almost US $300 million. *Supra* note 111 at 19, 36.

[134] Banka e Shqiperise, Departamenti i Marredhenieve Publike, Deklarate per Shtyp e Guvernatorit – Zhvillimet Ekonomike ne gjashtemujorin e dyte te vitit 2004 dhe pritjet per vitin 2005, online: Banka e Shqiperise <http://www.bankofalbania.org> (accessed March 14, 2005) [translated by author].

[135] *Supra* note 115 at 1.

[136] *Ibid.* at 3.

[137] See the Law "On Buying and Selling Building Sites" No. 7980, dated July 27, 1995, Official Gazette No. 18, Article 5.

The EU began its negotiations with Albania on a Stabilization and Association Agreement (SAA), which is the first step toward its entry into the EU, in January 2003.[138] However, Albania has not been given a date for its final admission into the EU. Keeping in mind that Bulgaria, for example, is hoping to join the EU in 2007, almost 12 years after it first began negotiations with the EU,[139] one may conclude that Albania still has a long way to go before it gains EU membership.

The political situation in Albania is far from completely stabilized. Local elections in 2003 had to be repeated in many areas because of irregularities and violations of election rules.[140] The main opposition party, the Democratic Party of Albania (DPA), refused to accept its loss and incites political instability by organizing regular street demonstrations against the government, rejecting all efforts of the government for economic reforms.[141] As one report of the European Bank for Reconstruction and Development notes, "Albania continues to suffer from problems such as high level of corruption and organized crime, poor law enforcement and weak administrative and institutional capacity."[142] These factors affect negatively the development of the private sector and the flow of FDI into Albania.

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[138] European Commission, *Occasional Papers – The Western Balkans in Transition* (Brussels: European Commission, 2004) at 27.

[139] Stanimir Alexandrov & Latchezar Petkov "Paving the Way for Bulgaria's Accession to the European Union" (1997-1998) 21 Fordham Int'l L.J. 587 at 587;

[140] *Supra* note 82 at 1.

[141] *Ibid.*

[142] *Ibid.*

2. Croatia

Croatia declared its independence from the Federal Republic of Yugoslavia (FRY) in 1991 and the FRY responded by attacking the separatist republic a few weeks later.[143] The war that engulfed Croatia, Bosnia-Herzegovina and what remained of Yugoslavia continued relentlessly until 1995[144] when it finally ended with the signing of the Dayton Peace Agreement.[145]

Croatia used to be one of the most developed republics of Yugoslavia[146] and traditionally Croatians have considered themselves more related to Western Europe than Eastern Europe in their culture, politics and economic relationships.[147]

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143 Sinisa Malesevic, *Ideology, Legitimacy and the New State: Yugoslavia, Serbia and Croatia* (London: Frank Cass Publishers, 2002) at 224.

144 Peter W. Galbraith, "Washington, Erdut and Dayton: Negotiating and Implementing Peace in Croatia and Bosnia-Herzegovina" (1997) 30 Cornell Int'l L.J. 643 at 644.

145 Bosnia and Herzegovina, Croatia, Yugoslavia, General Framework Agreement for Peace in Bosnia and Herzegovina, initialed Dayton, Ohio, 21 November 1995; signed Paris, 14 December 1995, 35 I.L.M. 75 (1996).

146 Janine S. Hiller & Snjezana Puselj, "Progress and Challenges of Privatization: The Croatian Experience" (1996) 17 U. Pa. J. Int'l Econ. L. 383 at 383-384. See also *supra* Chapter I, note 11 at 110.

147 Tomislav Sunic, "From Communal and Communist Bonds to Fragile Statehood: The Drama of Ex-post-Yugoslavia" *The Journal of Social, Political and Economic Studies*, 23:4 (Winter 1998) 465 at 468; James H. Martin & Bruno Grbac, "Smaller and Larger Firms' Marketing Activities as a Response to Economic Privatization " *Journal of Small Business Management*, 36:1 (January 1998) 95 at 95.

However, the conflict of 1991-1995 cost Croatia twenty thousand deaths[148] and almost US $ 20 billion in damages;[149] 210,000 houses had been destroyed, 30 percent of the industrial infrastructure had been ruined and more than 430,000 people had become refugees.[150] While it was unthinkable to discuss the issue of investment during the war, where the bare survival of everyone was at stake, the situation did not improve with the end of the war. It is estimated that Croatia spent in excess of US $ 1 billion just for the care of Bosnian war refugees.[151] The government that came to power after the end of the war was composed of the same political figures who had supported and contributed to the war and who had been long-time nationalists.[152] They continued to maintain a hostile policy toward foreign investors in Croatia while granting economic power through privatization mainly to relatives,[153] friends and political supporters.[154] It was not until 2000, when the parties in power lost the general elections, and the winning coalition moved toward adopting legislation that would promote foreign investment and attract foreign investors. At this time, almost

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[148] Jasminka Udovicki & James Ridgeway, eds., *Burn This House: The Making and the Unmaking of Yugoslavia* (London: Duke University Press, 2000) at 160.

[149] *Supra* note 146 at 383-384.

[150] Marcus Tanner, *Croatia, A Nation Forged in War* (New Haven and London: Yale University Press: 1997) at 278.

[151] Vitomir Miles Raguz, "Balkans in NATO" (2001) 23 Harvard International Review 26 at 28.

[152] *Supra* note 150 at 200-201.

[153] *Supra* note 142 at 230.

[154] For example, in 1999 41.4% of new managers of recently privatized enterprises belonged to the HDZ party in power in Croatia. See Branimir Kristofic, "Who is Running Croatia Enterprises?" *Post-Communist Economies* 11: 4 (December 1999) 503 at 509.

five years after the end of the war, the situation in Croatia is described by a Croatian government report as "an economy in recession",[155] and among the main reasons for this situation are "the non-existence of a stimulating development policy, slow accession of Croatia to international associations... and non-functioning of the legal system and inefficient judiciary."[156]

From the legal point of view, Croatia took several steps toward the liberalization of its economy and the free market system. Croatia adopted the Company Act[157] at the end of 1993, which replaced the old Yugoslavian legislation.[158] This law allows new forms of enterprises to be established in Croatia such as general and limited partnership companies[159] as well as joint-stock companies.[160] The Company Act also provides procedures for foreign companies to do business in Croatia, beginning with registration and a series of other requirements.[161]

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[155] Ministry of Economy of Croatia, *Croatia Country Report* (Zagreb: Ministry of Economy, 2000) at 4.

[156] *Ibid.*

[157] Official Gazette No. 111 (1993) [hereinafter the Company Act].

[158] *Supra* note 146 at 392.

[159] The Company Act, Article 68.

[160] *Ibid.* at Article 159.

[161] *Ibid.* at Article 612.

The Company Act was followed by the Law on the Transformation of Socially Owned Enterprises[162] (or the Privatization Act). This Act first transformed the once socially-owned companies into joint-stock or limited liability companies and then put them up for privatization.[163] This transformation was necessary in order to guarantee the necessary protection of property ownership by potential foreign companies which were expected to participate in the process of privatization of the Croatian economy. The privatization process encountered difficulties caused by the misunderstanding of the privatization strategies of the Croatian government,[164] perceived governmental corruption and preferential treatment,[165] as well as the slowness of the process.[166] Two of the largest companies in Croatia, Croatian Telecom and Privredna Banka, were privatized only in 1999[167] to German and Italian investors respectively.

[162] Official Gazette No. 19 (1991) [hereinafter Privatization Act].

[163] Supra note 146 at 396.

[164] *Ibid.* at 409.

[165] *Ibid.* at 411. See also *supra* note 68 at 139.

[166] *Supra* note 146 at 411.

[167] *Supra* note 155 at 9.

i. Croatia's Investment Law

Croatia's legislation that deals directly and specifically with investments is the Investment Promotion Law, adopted in 2000.[168] It is quite appalling that it took Croatia almost five years after the end of the conflict to draft a law that governs investments, especially since Croatia does not have a special law on foreign investments – the Investment Promotion Law regulates both domestic and foreign investment and makes no distinction between the two. This fact could be interpreted as an implicit statement of the national treatment principle, that foreign investment will receive the same guarantees and protection as domestic investments. The Investment Promotion Law does not contain any provisions that refer explicitly to the national treatment principle, MFN principle, expropriation, compensation or any of the other principles and standards discussed in Chapter III and that are found in the Albanian 1993 Law.

The Croatian investment law in reality contains an extensive set of incentive measures, tax and tariff privileges, contained in Article 1(2). However, the law seems to contain several limitations which may restrict its effect on the promotion of, at least, foreign investment in the country. The definition of "investor" in Article 2(1) is limited by the amount of the capital invested – individuals or companies investing

[168] Official Gazette No. 73 (2000) [hereinafter the Investment Promotion Law] – reprinted in Appendix B. See UNCTAD, *UNCTAD WID Country Profile: Croatia* (New York and Geneva: United Nations, 2002) at 1.

under a certain minimum are not considered as "investors" for the purposes of this law. In Article 9, the meaning of "special economic interests" which may bring about preferential treatment of foreign investors in terms of incentive measures and tax and tariff privileges by Croatia seems to be unclear. The Investment Promotion Law provides for many tax benefits and governments subsidies for investors regardless of the nationality of the investment.[169] Other laws complement the Investment Promotion Law in its application, such as the Corporate Profit Tax Law,[170] the Personal Income Tax Law[171] and the Law on Free Zones.[172]

Croatia has signed almost 40 BITs with countries in South East Europe, Western Europe, North America, Asia and Africa.[173] The Croatian BIT with the US,[174] signed in 1996, is one of the most comprehensive BITs signed by Croatia. It contains 27 articles in 15 pages and an Annex. This BIT provides for the national treatment and MFN principles in Articles II and IV, and guarantees no restrictions on transfers in Article VI and no performance restrictions in Article VII. Investment

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169 For example, for each new employee recruited, the government of Croatia provides about US$ 2,100 to the recruiting company, as well as up to 50% of costs related to training or retraining of employees. See the Investment Promotion Law, Article 4(1) and 4(4).

170 Official Gazette No. 177 (2004).

171 Official Gazette No. 177 (2004).

172 Official Gazette No. 44 (1996).

173 For a complete list of BITs negotiated and signed by Croatia, see UNCTAD – Investment Instruments Online, Bilateral Investment Treaties, online: UNCTAD <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (accessed March 14, 2005).

174 See Croatian BIT with the US (1996). *Ibid.*

disputes shall be resolved by means of arbitration tribunals pursuant to Article X. The Annex contains certain reservations that both countries have expressed with regard to the regime of investment regulations governing the economic relationship between the two countries. The US has stated that certain of its industries, such as the atomic energy, broadcasting, fisheries, air and maritime transport, will be excluded from the rules and regulations provided for by the BIT. Croatia has chosen practically the same areas of economic activity for exclusion from the rules of this treaty.

Croatia also signed a BIT with Canada in 2001.[175] This treaty belongs to the groups of treaties adopted in the post-NAFTA period and, as discussed above in Chapter II, it is, in general, influenced by NAFTA Chapter 11 novelties, such as stronger provisions prohibiting performance requirements and the investor-state arbitration dispute mechanism. Other important BITs signed by Croatia include the BIT with the UK (1997); the BIT with Germany (1997); the BIT with Italy (1996) and the BIT with Austria (1997). These agreements are short and contain only a few articles that provide for the basic principles and standards found commonly in all BITs. They resemble the Canadian BITs in the pre-NAFTA period.

[175] Canadian FIPA with Croatia, Can T.S. 2001/4.

ii. The Banking system in Croatia

At the end of 1989, the banking system in Croatia was in a catastrophic state, when bad loans reached the same level as the capital of the banks.[176] The banking crises continued even after the dissolution of Yugoslavia; in 1991, more then one-third of the banks in the country were declared insolvent.[177] At about this time, the new Croatian government approved the law "On the Croatian National Bank"[178] and the law "On Banks and Savings Institutions",[179] in order to restructure the banking system. However, even after the implementation of the two laws and the end of the war, banks experienced failure after failure; two banks went bankrupt in 1998 and six others in 1999.[180] One of the factors that influenced the course of these events was the financing by these banks of badly managed newly privatized enterprises which were in the hands of people with political connections.[181] The number of foreign banks in Croatia has grown during recent years.[182] However, banks still continued to

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[176] Mario I. Blejer & Marko Skreb, eds., *Transition: The First Decade* (Cambridge: The MIT Press, 2001) at 214.

[177] *Ibid.*

[178] Official Gazette, No. 74 (1992).

[179] Official Gazette, No. 94 (1993).

[180] *Supra* note 176.

[181] *Ibid.* at 221.

[182] At the end of 2000, the share of state ownership in the banking system was only 6.1 percent. Igor Jemric & Boris Vujcic, "Efficiency of banks in Croatia: A DEA Approach" *Comparative Economic Studies* 44:2/3 (Summer 2002) 169 at 172.

experience problems in 2000 and 2001.[183] Needless to say, the trust of the general public in Croatian banking institutions was shattered.[184]

ii. The IP laws in Croatia

With regard to IP, today Croatia has an extensive system of IP laws. Most of the legislation in existence in Croatia was amended and modernized by a package of laws on IP adopted in 1999.[185] Croatia also became a contracting party to the main international treaties on protection of IP.[186] However, there are still problems with the implementation of these laws. The US continues to keep Croatia on the Special

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[183] *Ibid.*

[184] Today, the banking legislation in force in Croatia is made up mainly of law "On the Croatian National Bank", Official Gazette No. 36 (2001) and the "Banking Law" Official Gazette 84 (2002).

[185] The law "On Amendments of the Copyright Law", Official Gazette No. 76 (1999) amended the previous laws "On Copyright", Official Gazette No. 53 (1991) and No. 58 (1993), the Industrial Design Law, Official Gazette No. 78 (1999) and the Patent Law, Official Gazette No. 78 (1999) amended the previous Industrial Property Law, Official Gazette No. 53 (1991), No. 61 (1992) and No. 26 (1993).

[186] Croatia became a contracting party to the Berne Convention in 1991; the Paris Convention in 1991 and the WTO TRIPs agreement in 2000. See World Intellectual Property Organization – WIPO Administered Treaties, online: World Intellectual Property Organization <http://www.wipo.int/treaties/en> (accessed March 14, 2005). See also World Trade Organization – World Trade Membership of Albania, Croatia Approved, online: World Trade Organization <http://www.wto.org/english/news_e/news00_e/gcounc_e.htm> (accessed March 14, 2005).

301 Watch List 2004 because of their concerns regarding its patent regime, mainly issues related to confidentiality and judicial remedies.[187]

iv. Croatia post-1999

While the crisis in Kosovo in 1999 did not affect Croatia directly, it still had negative effects on its economy because of the destabilization effect of an ongoing war in a neighboring country. Keeping in mind the fact that Croatia opened its air space for NATO air planes involved in the bombing campaign over Yugoslavia, the losses to the economy were estimated at US$ 1.5 billion, an amount which is equal to seven percent of the country's GDP.[188]

After the death of President Tudjman in December 1999, his HDZ party lost both parliamentary and presidential elections.[189] This marked the beginning of a new transition in Croatia. A series of laws were adopted in order to improve the economic

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[187] A US-Croatia Memorandum of Understanding was ratified by the Croatian Government only in February 2004, more than four years after it was signed in 1998. See Office of the United States Representative, online: Office of the United States Representative <http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_Special_301/asset_upload_file16_5995.pdf> at 24 (accessed on March 14, 2005).

[188] *Supra* note 151 at 28.

[189] *Supra* Chapter I, note 11 at 109.

situation and attract investments.[190] The new government reviewed some of the privatization affairs but not the entire process.[191] In 2003, Croatia enacted other important economic laws and one of the largest state-run companies in the oil sector, INA, was privatized partially.[192]

The general lack of FDI in Croatia, despite its increasing potential, is mainly attributed to the war and its aftermath, the unstable political situation in the region and the "protection of vested interests within the country."[193] Still, the UNCTAD World Investment Report of 2004 lists Croatia among countries that have shown a high FDI performance (in attracting foreign investments) during 2000-2002 when compared to other countries of the region.[194] FDI has been on the increase in Croatia. In 1993, FDI was only US$120 million, while in 2003 it was close to US$2 billion, and for the first three quarters of 2004 it was more than US$870 million.[195] The main trading partners of Croatia are Italy, Germany and Austria.[196] Croatia's GDP during

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[190] E.g. the Investment Promotion Law, the Charter of the Croatian Privatization Fund, Official Gazette 59 (2000), amendments to the Privatization Act, Official Gazette 73 (2000), the General Tax Code, Official Gazette 127 (2000).

[191] *Supra* Chapter I, note 11 at 123.

[192] *Supra* note 137 at 27.

[193] *Supra* note 176 at 245.

[194] *Supra* Chapter II, note 120 at 17.

[195] Data from Croatian National Bank – Foreign Direct Investment Statistics, online: Croatian National Bank <http://www.hnb.hr/statistika/estatistika.htm> (accessed March 14, 2005).

[196] *Supra* note 137 at 43.

2003 increased by 4.3 percent, inflation at the end of 2003 was 1.8 percent,[197] while the unemployment rate in April 2003 stood at 20.4 percent.[198] In December 2004, however, the unemployment rate had dropped to 18.7 percent.[199] The privatization of large public companies is still an ongoing process,[200] the liberalization of markets is still non-existent[201] and the unemployment rate is still high.[202] Future reforms should include the enactment of new legislation according to European standards, impartial and efficient functioning of the courts, and modernization and professionalism of the public administration.[203]

Croatia signed its SAA with the EU in October 2001 and presented its application for EU membership in February 2003.[204] In June 2004, Croatia became an EU candidate country and is hopeful to begin the adoption and implementation of

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197 Data from Croatian National Bank – General Information on Croatia – Economic Indicators, online: Croatian National Bank <http://www.hnb.hr/statistika/estatistika.htm> (accessed March 14, 2005).

198 United States of America, Department of Commerce – U.S. Commercial Service, online: U.S. Commercial Service, Economic and Trade Statistics <http://www.buyusa.gov/croatia/en/economicandtradestatistics.html> (accessed March 14, 2005).

199 Republic of Croatia – Central Bureau of Statistics, online: Republic of Croatia – Central Bureau of Statistics <http://www.dzs.hr/defaulte.htm> (accessed March 14, 2005).

200 National Competitiveness Council, *55 Policy Recommendations for Raising Croatia's Competitiveness* (Zagreb: National Competitiveness Council, 2004) at 7.

201 *Ibid.*

202 *Ibid.*

203 *Ibid.* at 27.

204 *Supra* note 137 at 42.

the complex EU legislation in early 2005.[205] The HDZ returned peacefully to power in December 2003, but they have maintained the same economic route as the preceding government, seeking membership in the EU and NATO.[206] The new government is drafting new regulations offering more incentives to foreign investors that contribute with large amounts of capital.[207] However, recently, a few cases of alleged public tender manipulations have caused some concern for foreign investors.[208]

c. Suggestions on improvements for the future in Albania and Croatia

As mentioned earlier, many factors – political, legal, cultural, and historical[209] – influence the flow of FDI toward one country or another. One of these factors that plays a tremendous role in the decision-making of a company to invest in a foreign country is the political stability of that country.[210] In a country where there is a

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205 United States of America, Department of Commerce – U.S. Commercial Service, online: U.S. Commercial Service, Investment Climate Statement <http://www.buyusa.gov/croatia/en/investmentclimatestatement.html> (accessed March 14, 2005).

206 *Ibid.*

207 *Ibid.*

208 *Ibid.*

209 Supra Chapter III, note 44 at 383.

210 Here one author affirms that "the first and most critical set of obstacles to economic integration are political..." George A. Kourvetaris et. al. eds., *The New Balkans: Disintegration and Construction* (New York: Columbia University Press, 2002) at 259.

continuity of economic governance and economic policies regardless of the political party in power, foreign investors will be able to predict potential risks.[211] As Albania and Croatia move toward entry in the EU and other European institutions, it is indispensable for them to ensure the peaceful transition of power from one political coalition to the other. The lack of political will to implement real market economy reforms (because of the potential adverse reaction from the population) as well as the continuous hostile stance of the opposition, destabilize the fragile economic equilibrium in Albania and hold back prospective investors.[212] This lack of political stability has also endangered the prospects of Albania for joining Euro-Atlantic structures.[213] Since the South East European countries often are motivated to make all kinds of reforms mainly by the incentives of joining the EU and NATO,[214] these organizations should keep up their pressure on Albania and Croatia to carry out economic reforms.

Political stability cannot be achieved without the establishment of macroeconomic stability and ensuring economic growth and development. While measures to achieve this economic progress are not the focus of this thesis, it is worth noting that the undertaking of economic reforms toward guaranteeing a free market economy and raising the standard of living in Albania and Croatia is an incentive for

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211 *Ibid.* at 239.

212 "Reform Fatigue In Albania" *Emerging Markets Monitor* 9:46 (March 2004) at 1.

213 *Ibid.* at 13.

214 *Supra* Chapter I, note 8 at 214.

attracting FDI. The process of privatization should be completed very soon in both countries[215] in order to both increase state revenues and attract FDI. GDP growth and reduction of unemployment are also some of the measures that would improve the economic development of both countries. The trust in the banking system should be revived and banking services should be expanded and modernized, especially in Albania, particularly with regard to loans for enterprises,[216] something which has been largely lacking in Albania.[217]

Albania and Croatia should continue to pursue a policy of economic liberalism with regard to FDI in order to attract the much-needed foreign investors. Since the level of FDI in both countries is lower than they have expected and arguably lower than what their economies need, increasing incentives for FDI and encouraging foreign investors is what these countries should strive to achieve. In most instances, the adoption of economic nationalist policies, while they may protect certain domestic industries which are in their initial stages of development,[218] will cause more harm than good, taking into account that generally FDI is not overflowing in these countries even though Albania and Croatia have adopted policies based on

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[215] *Supra* Chapter I, note 11 at 127; see also *supra* note 82 at 1.

[216] Gertrude Tumpel-Gugerell et al., eds., *Completing Transition: The Main Challenges* (Heidelberg: Springer-Verlag, 2002) at 105.

[217] *Supra* note 116 at 77.

[218] The largest state-run enterprises in Albania are expected to be privatized during 2005. See *supra* note 82. Also in Croatia the privatization of larger companies is still an ongoing process. See *supra* note 200.

economic liberalism. However, in limited areas that are found to hold special economic importance for the well-being of the state or its citizens, economic nationalism is justified and domestic legislation should ensure that these important industries continue to be managed by the state or domestic enterprises.[219]

Strengthening the rule of law, building transparent governing authorities and independent and impartial judiciaries should be other priorities for the governments of Albania and Croatia. Corruption is still a plague that damages the reputations these counties are attempting to create and it also keeps foreign investors away.[220] Transparency in decision-making about privatization and other economy-transforming decisions, as well as in the debate over the drafting of laws and regulations and their following publication, is also very important. However, at the moment, public information on laws and regulations is still lacking. Both governments have yet to create a database of laws and articles easily accessible and available to the public.[221] Existing laws should be improved and updated, especially

[219] See e.g. Albanian 1993 Law, Article 2(1), where foreign investors are prohibited from land ownership in Albania. This purchase is regulated by the Law "On Buying and Selling Building Sites" No. 7980, dated July 27, 1995, Official Gazette No. 18, which also contains a restriction on sale of land to foreign investors. See *supra* note 127. Depending on how this provision is applied it may became a restriction on FDI or a justified measure to protect this legal relationship over the land, determined as extremely important by the Albanian legislature.

[220] *Supra* note 205; see also *supra* note 82 at 2.

[221] The websites of the two main FDI promotion agencies in Albania, AEDA and ANIH, do not contain a list of laws or regulations related to FDI in Albania. While they offer useful information, by naming few of these laws and their main provisions, sometime this information is not updated, is incomplete

since both countries have started negotiations with the EU, a long and complex process that requires, among other things, the adoption of numerous laws and treaties in order to harmonize their domestic laws with the EU legislation.[222] Also, even more important, the implementation of domestic laws should be enforced by competent and motivated authorities.[223] The actual problems related to lack of FDI in Albania are due not as much to the absence of advanced and proper legislation in the area of FDI and other related areas, but to the lack of skilled and competent institutions to implement them.[224] Finally, impartial and independent courts, as the final guardians of the administration of justice, have an immense role to play in making sure that perpetrators are sentenced[225] and that there is justice for all.

In terms of more practical legal suggestions, the Albanian Investment Law should be amended. While this law initially provided sufficient levels of protection for foreign investment at the time when it was adopted, it lacks incentives to attract these investments today. Even compared to the Investment Promotion Law of

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and, at times, is contradictory. The author had to rely on personal contacts to find the English version of the Law of Foreign Investment (which is the basis of all FDI activity in Albania).

[222] *Supra* note 82 at 15.

[223] *Supra* note 137 at 34, 48.

[224] Even though Law No. 7523, August 10, 1991, "On Sanction and Protection of Private Property, Free Initiative and Privatization" has been in existence and effect for more than 10 years, large state-run companies still are not privatized. The FDI promotion agency, ANIH, was created only in 2002, more than 10 years after the first FDI entered the country. See *supra* note 130.

[225] *Supra* note 82 at 13.

Croatia, the Albanian Investment Law lacks important provisions that would stimulate the flow of FDI.[226] In Albania, taxes on businesses remain high and foreign ownership of agricultural land is prohibited.[227] These restrictions make Albania less preferable in the eyes of investors as a potential host country.

Albania should follow largely the model of the Canadian IC Act which provides rules for the regulation of foreign investments in Canada.[228] While I will not focus on every single aspect of the IC Act or the Albanian Investment Law, important points to be noted for future improvements of the Albanian investment law include specifying in the law the institutions and government officials who are responsible for the implementation of the law.[229] In the IC Act these institutions and government officials are clearly identified and their duties are also specified.[230] It is important to identify the institutions with which foreign investors will have to deal in order to establish their investment in Albania or Croatia. The duties of these institutions, the procedures these institutions use in carrying out their assigned duties[231] and the notification procedure to be followed[232] – so that a record of FDI in the country may be kept by a central agency charged with the coordination of all inward flows of FDI

[226] See e.g. Article 4 of the Croatian Investment Promotion Law, *supra* note 168.

[227] *Supra* note 125 at 6.

[228] See Article 2 of the Canadian IC Act, *supra* Chapter I, note 29.

[229] See Articles 4, 5 and 6 of the Canadian IC Act, *supra* Chapter I, note 29.

[230] *Supra* Chapter I, note 29 at s. 4, s. 5 and s. 6.

[231] *Ibid.* s. 13 and s. 14.

[232] Ibid. s 11.

– are other points that must be included in an investment law, in order to make this legislation a one-stop shop for foreign investors and to facilitate their efforts in becoming familiar with the domestic legislation of Albania and Croatia. While currently Albania does not have a review process for FDI and there is no need for prior authorization for the entry of FDI into Albania,[233] if prior authorization is to be taken into consideration in the future, then when domestic industries are sufficiently developed to successfully compete with foreign investors, the IC Act can provide a successful model for the establishment of an investment review agency in Albania.[234]

The limitations identified in the Albanian 1993 Law should be removed. The MFN principle should be expressly included alongside the national treatment principle and the minimum standard of treatment principle. While it may be wise to maintain the restriction on land ownership for foreign investors, taking into account the limited land mass of Albania, the existence of this provision should be argued and justified on an economic basis. The new investment law should also include incentives in order to attract foreign investment as well as resolve the issue of foreign ownership of agricultural land.[235] The provisions on the arbitration process also need to be streamlined in order to allow more flexibility even in the case when foreign investors have not considered how potential investment disputes may be resolved. Finally, while international agreements automatically become the law of the land upon their ratification, this does not mean that they also become automatically

[233] See Article 2 of the Albanian 1993 Law, *supra* note 86.

[234] See Article 14 of the IC Act, *supra* Chapter I, note 34.

[235] *Supra* note 125 at 6.

available to practitioners, judges or foreign investors. The Albanian investment law must refer specifically to those international agreements that affect its implementation and must be annually updated, e.g. in the form of an appendix listing those international agreements that are related to FDI in Albania.

The Croatian Investment Promotion Law also has room for improvement. While it provides numerous incentives for investors regardless of their nationality, the definition of "investor" is linked to a specific amount of capital invested[236] which is not found in the Albanian or the Canadian domestic legislation. This may limit the number of potential investors, especially those interested in investing small amounts or investing in small enterprises. Also, the meaning of "special economic interests"[237] needs to be clarified with an eye on enhancing the transparency and the precision of the legislation. The Croatian Investment Promotion Law does not contain any provisions that refer explicitly to the national treatment principle, MFN principle, expropriation, compensation or any of the other principles and standards discussed in Chapter III and that are found in the Albanian 1993 Law. While all these principles are easily identifiable by resorting to Croatian BITs, it would facilitate the process of becoming familiar with the FDI legislation in Croatia if these principles and standards were included in a specific law on FDI. The Croatian law can also benefit from an investment review agency found in the IC Act in the same way as

[236] See Article 2(1) of the Croatian Investment Promotion Law. This amount is 4 million kunas (about US$ 700,000). Investment Promotion Law, *supra* note 168.

[237] See Article 9 of the Croatian Investment Promotion Law, *ibid.* note 168.

Albania, as set out in the foregoing paragraph, with provisions on a notification procedure for future investments, the institutions and government officials responsible for implementation of the law and the duties and the procedures of these institutions. Further, investment laws in both Albania and Croatia should offer complete information to a potential foreign investor on the state of operation and protection of FDI in their countries, in order to make the investor's research process as easy and understandable as possible.

BITs already signed by Albania and Croatia need to be amended and BITs expected to be signed in the future also need to be restructured. While it is generally true that developing nations usually do not have much say in the drafting of Model BITs (as most of them are already drafted in advance by developed countries and only presented for signature to interested developing nations),[238] the latest US Model BIT and Canadian Model FIPA improvements should be taken into consideration in future negotiations on BITs by the respective negotiating authorities in both countries. These advanced principles and standards[239] can serve as indicators and examples for drafting new BITs or amending existing ones. For example, these BITs should include provisions on regulatory measures that amount to indirect expropriation, the existence of joint government commissions for overseeing the implementation of the BIT (modeled after the "Commission" as specified in Article 51 of the 2004 Canadian

[238] E.g. compare Canadian FIPA with Romania, Can T.S. 1997/47, Canadian FIPA with Venezuela, Can T.S. 1998/20 and, Canadian FIPA with Panama Can T.S. 1998/35 to see that Canadian FIPAs repeat almost verbatim the same provisions on investment protection and promotion.

[239] See *supra* Chapter III, text accompanying notes 89 to 98.

Model FIPA)[240] and any arbitration dispute that may arise in the future, as well as regulations that would provide for certain obligations for foreign investors, in addition to the host country obligations.

While it may take more than improving banking laws in Albania and Croatia to reinstate the trust of depositors in banks, laws should still aim to provide the necessary prerequisites for the existence of this trust. The Albanian law "On the Insurance of [Bank] Deposits" adopted in 2002 intended to guarantee to bank clients that their deposits were safe even in cases of bankruptcy or liquidation of the banks. However, this law limits the amount of bank deposits that may be insured to about US $ 7,000.[241] While this may be regarded as a considerable amount by Albanian standards,[242] at the same time it is a very small amount in terms of savings for retirement or other long-term plans. This provision needs to be amended to provide for a state guarantee of a much larger amount.[243] Another way to increase the trust of the citizens in the banking system is to ensure the safety and oversight of the banking system so that cases of bank failures are prevented, e.g. improving the control over bank loans.

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[240] *Supra* Chapter III, note 82.

[241] Law No. 8873, March 29, 2002, Official Gazette No. 6, article 5(a). See also Albanian Insurance Deposit Agency – Sigurimi i Depozitave, Ligji, online: Albanian Insurance Deposit Agency <http://www.dia.org.al/default.asp?faqja=ligji.htm> (accessed March 14, 2005) [translated by author].

[242] The minimum monthly wage in Albania is only US $110. See *supra* note 111 at 33.

[243] See *supra* Chapter IV, text accompanying notes 33 to 37. In Canada, bank deposits are guaranteed up to C$ 60,000, while in the US this amount is even higher, US $ 100,000 per individual.

Another factor that indirectly affects negatively the Croatian economy is insufficient cooperation with the International Criminal Tribunal for the Former Yugoslavia (ICTY), especially on the Gotovina case.[244] The EU and the US have underlined that the full cooperation of Croatia with the ICTY is a pre-condition for the continuance of assistance projects and the beginning of negotiations for the admission of Croatia into the EU.[245]

On a final cultural note, another thing that should be improved both in Croatia and Albania is the culture regarding the way in which entrepreneurs and the market economy are viewed. Often, businesspeople are considered as "people who want to get rich quick and who operate on the edge of the law."[246] In Albania, the free market and democracy have been interpreted for many years as the absence of all government control and irresponsibility toward government rules and regulations.[247]

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[244] Croatian General Ante Gotovina was indicted on May 21, 2001 by the ICTY on eight counts, including crimes against humanity and violations of the laws or customs of war committed during 1995 against Croatian Serbs in Croatia. Gotovina is still at large. See ICTY Case No. IT-01-45-I – The Prosecutor of the Tribunal Against Ante Gotovina, available at <http://www.un.org/icty/indictment/english/got-ii010608e.htm> (accessed March 14, 2005).

[245] Government of the Republic of Croatia - February 10, 2005 - Gotovina must end up in the Hague before Croatia's EU entry talks - French, German Ministers, online: Government of the Republic of Croatia <http://www.vlada.hr/default.asp?gl=200502110000004> (accessed March 14, 2005).

[246] *Supra* note 200 at 43.

[247] *Supra* note 122 at 29, 32.

These incorrect concepts represent obstacles to the admission of foreign investors and to their cooperation with domestic entrepreneurs.

d. Conclusions

The post-Communist developments in Albania and Croatia have been similar. After breaking the chains of Communism in the early 1990s, they both undertook a series of reforms with the goal of advancing toward democracy and a market economy. While Croatia was caught up in the regional war with the former Yugoslavia, Albania fell into the claws of semi-authoritarianism and, instead of democracy and the rule of law, built an authoritarian regime comparable to the half-century reign of Communism. This "democratic" regime melted away overnight in 1997 and the unrest continued spontaneously until late 1999. The same fate was in store for Croatia after the 1991-1995 war up to the end of 1999, when the state administration resembled that of the long gone Socialist Yugoslavia.

As both countries began a second phase of transition in early 2000, numerous challenges still remain. Achieving political stability, further economic growth and development of the free market economy, as well as privatization of large state-run enterprises are some of these challenges. Building the rule of law, reliable and competent state authorities and an impartial and independent justice system are a few others.

In terms of particular legal developments, both the Albanian and the Croatian legislation related to FDI need revisions and amendments. Their investment promotion laws still contain restrictions and limitations directed toward foreign investors. As Albania and Croatia aim at EU membership and move forward in their respective negotiation processes, this need to amend their FDI laws will become even greater and the pace of legislative amendments even faster in order to harmonize their domestic laws with that of the EU system. Therefore, now is the time to take the first steps in this complex and lengthy task in both Albania and Croatia. The Canadian model of domestic legislation, in particular the IC Act, as well as the new US Model BIT and the Canadian Model FIPA can serve as examples to be followed for the modernization and streamlining of domestic legislation and international treaties in the area of foreign investment.

CHAPTER V

CONCLUSIONS

FDI is one of the most significant factors that influence economic development and growth in the contemporary world. While every economy has its own definition of what FDI comprises, all seem to agree on its importance in the technological advancement of, increase in production in and other benefits to the host country. Most countries strive to attract FDI to their economies through an array of international and domestic legal instruments.

Flows of FDI in the world are mainly regulated by bilateral investment treaties (BITs) – sometime called Foreign Investment Promotion and Protection Agreements (FIPAs) – which aim to promote and protect these investments in the host countries. BITs contain the regulatory standards, principles and obligations required of the host countries so that the operation of foreign enterprises in their territory will be encouraged, facilitated and protected. These standards, principles and obligations are essential if the host country is to catch the attention of potential foreign investors.

As argued in Chapter III, the standards, principles and obligations of BITs contain little value if they are not implemented and enforced through domestic laws, motivated domestic authorities and suitable economic policies adopted for this purpose. Domestic laws must reflect the spirit and the objective of BITs and should be the manifestation of these international obligations within the national legislative context. Motivated central and local authorities in the host countries must enable the operations of foreign investors in compliance with national laws and treat all foreign investors fairly. This is especially true for the judiciary as the most commonly used final dispute resolution system. On the same note, host countries should provide practical means for international arbitrations of disagreements between the host countries and investors as an alternative to judicial settlement in the host nation. Economic policies free from nepotism and favouritism which are oriented toward the free market economy, privatization of state-run companies and the rule of law provide the most important incentives for foreign investors.

As described in Chapter II, the US, the UK and Canada (with the exception of the FIRA decade) have maintained an economic liberal position toward FDI by encouraging and promoting FDI in most sectors of the economy. Their economic nationalist policies and laws are limited to those areas of the economy that are either strategic, extremely important to the well-being of the state or its citizens, or hold a unique special significance for the country. I argue that this mainly economic liberal position should be followed by Albania and Croatia in the revision of their domestic FDI laws and negotiation of future bilateral treaties on FDI.

Albania and Croatia, after 50 years under the rule of Communism, with their unique and extreme Marxist economic policies, are progressing toward free-market economies, complete democratization of their societies and are increasingly attracting

FDI for the development of their economies. In their efforts to transform their economies and legal systems they can benefit from the Canadian international and domestic law models regulating FDI.

Investment laws in Albania and Croatia need to be amended in accordance with the new economic realities in those countries according to the principles of the Canadian IC Act. It is important to: expand and clarify the definition of foreign investment, to provide for a clear institutional hierarchy of government bodies responsible for the administration and implementation of the law and to provide for the respective duties of these government bodies and the procedures to be followed in fulfilling these duties. A review process for permitting FDI may become necessary at some point in the future in the Albanian and Croatian legislation and the IC Act provides a good model for the establishment of such a procedure.

Banking laws are also extremely important, but even more essential is the trust of the citizens in the banking system in general. One way to increase this trust in Albania and Croatia is by adopting banking laws that include stronger guarantees for clients' deposits in cases of bank failures or liquidations. The other way is to ensure the safety and oversight of the banking system in order that such market irregularities are avoided. With regard to IP laws, while the current laws are satisfactory in theory, Albania and Croatia should aim to ensure their proper implementation in reality. The lack of protection of IP is a serious obstacle for many foreign investors and, as such, measures must be taken in order to guarantee the necessary protection of this type of FDI.

The BITs entered into by Albania and Croatia must be improved in accordance with standards, principles and obligations contained in Canadian FIPAs, especially taking into consideration the innovations of the latest 2004 Canadian Model FIPA (and 2004 US Model BIT). While Albania and Croatia may not have much say in drafting their own BITs, as most BITs are already drafted by developed countries which are presented then to developing countries, it is essential to keep abreast of the latest developments in the BITs regime, so that when the economies of both these countries become more appealing to foreign investors, negotiations on future BITs may be concluded on more favourable terms for the host countries of Albania and Croatia.

The economies of Albania and Croatia have a long path in front of them as they proceed with the SAA processes to join the EU. The progress in these processes will depend on the political will of the parties in power, the abilities and the willingness of the citizens of these countries, as well as on the economic and legal changes so that the legislation of Albania and Croatia will be harmonized with that of the EU. This thesis has prescribed suggestions and ideas on how to improve the domestic legislation in Albania and Croatia, as well as the internal political and economic environments in these countries, in order to attract more FDI for the development of their economies, increase the standards of living of their populations, and, in the long run, facilitate the eventual integration of Albania and Croatia into the European family of nations.

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Czech and Slovak Federal Republic - Can T.S. 1992/10.
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APPENDIX A

ALBANIAN INVESTMENT LAW

(The English translation of the Albanian Investment Law can been found on the New York University School of Law website: http://www.law.nyu.edu/eecr/bycountryrefs/albaniaForeignInvest.html)

LAW

No. 7764, dated 02.11.1993

"On foreign investments"

Based on article 16 of Law no. 7491, dated 29.04.1991, "On the main constitutional provisions", on the proposal of the Council of Ministers,

THE PEOPLE'S ASSEMBLY

OF THE REPUBLIC OF ALBANIA

DECIDED:

Article 1

General provisions

For the purpose of this law, "territory" means the territory under the sovereignty of the Republic of Albania, including territorial waters, maritime zones and continental shelf, over which the Republic of Albania, in accordance with international norms, exercises its legal and sovereign rights.

- "Foreign investor" means:

a) every physical person who is a citizen of a foreign country; or

b) every physical person who is a citizen of the Republic of Albania, but resides outside the country; or

c) every legal person established in accordance with the law of a foreign country,

who directly or indirectly seeks to carry out or is carrying out an investment in the territory of the Republic of Albania in conformity with its laws, or has carried out an investment in conformity with its laws during the period from 31.07.1990 to the present.

- "Foreign investment" means any kind of investment in the territory of the Republic of Albania, performed directly or indirectly by a foreign investor, that consists of:

a) movable or immovable, tangible or intangible assets, or any other kind of ownership;

b) a company, rights that derive from any kind of participation in a company, by stock shares, etc;

c) loans, monetary obligations or obligations in an activity of an economic value and related to an investment;

ç) intellectual property, including literature and artistic, scientific and technological products, audio recording, inventions, industrial designs, schemes of integrated circles, know how, trademarks, designs of trademarks and trade names;

d) every right recognized by law or contracts and every license or permission issued in accordance with the laws.

- "Dispute over a foreign investment" means every disagreement or presumption caused by a foreign investment or related to it.

- "Revenue" means an amount of money that derives from or is associated with an investment, including profit, dividend, interest, reinvestment of the capital, costs of direction and administration, costs of technical assistance or other costs or contributions in kind.

Article 2

Permission and treatment

1. Foreign investments in the Republic of Albania are not conditioned upon prior authorization. They are permitted and treated based on conditions not less favorable than those afforded to domestic investments in similar circumstances, except land ownership, which is regulated by special law.

2. In all cases and at any time, investments have an equal and impartial treatment and enjoy complete protection and security.

3. In any case, foreign investments have treatment not less favorable than the one provided by generally accepted norms of international law.

Article 3

Right of employment

A company with the participation of foreign investments has the right to employ foreign citizens as well.

Article 4

Expropriation and nationalization

Foreign investments will not be expropriated or nationalized directly or indirectly, they will not be the subject of any measure equal to these measures, except in special cases, in the interest of the public use, defined by law, without any discrimination, with prompt, adequate and effective compensation, in accordance with legal procedures.

Article 5

Compensation for expropriation and nationalization

1. Compensation is equal to the real market value of the expropriated investment, at the moment when the expropriation act is undertaken or made public, whichever is first.

2. Compensation will be paid without delay and includes also the interest calculated upon a reasonable market rate, starting from the moment of expropriation; it is fully transferable and exchangeable calculated according to the market exchange rate on the date of expropriation.

3. A foreign investor has the right to request an immediate review of the expropriation or compensation act by the judicial authorities, according to the provisions of article 8 of this law.

Article 6

War and armed conflict

Foreign investors, whose investments suffer losses because of war, armed conflict, state of emergency or other similar situations, are treated in a way not less favorable than that provided to domestic investors regarding measures adopted for such losses.

Article 7

Transfers

1. Foreign investors have the right to transfer outside the territory of the Republic of Albania all funds and contributions in kind related to a foreign investment, including:

a) revenues;

b) compensation in accordance with article 5 of this law;

c) payments deriving from an investment dispute;

ç) payments made pursuant to a contract, including loan and interest payments made according to a loan agreement;

d) revenues deriving from the sale or the partial or complete liquidation of an investment;

dh) revenues deriving from reduction of the capital of the company in accordance with Albanian legislation.

2. Foreign investors have the right to perform these transfers outside the territory of the Republic of Albania in an easy convertible currency, calculated according to the spot exchange rate of transactions on the day of transfer in the currency in which their investments will be transferred.

3. The Republic of Albania may limit the transfer right through impartial and nondiscriminatory application of laws of a general character, including those regarding the payment of taxes and fulfillment of duties and court decisions.

Article 8

Dispute settlement

1. If a dispute arises between a foreign investor and an Albanian private party or an Albanian state enterprise or company, which has not been settled through an agreement, the foreign investor may choose to settle the dispute according to any kind of previously agreed upon and applied procedures. If there is no procedure foreseen for the settlement of disputes, then the foreign investor has the right to submit the dispute for resolution to a competent court or arbitrator of the Republic of Albania, according to its laws.

2. If a dispute arises between a foreign investor and the Albanian public administration, which has not been settled through an agreement, the foreign investor may submit the dispute for resolution to a competent court or arbitrator of the Republic of Albania, according to its laws. If the dispute relates to expropriation, compensation for expropriation or discrimination, as well as to transfers as provided in article 7 of this law, the foreign investor may submit the dispute for resolution to the International Center for Settlement of Investment Disputes ("Center"), established by the Convention for the settlement of investment disputes between the states and citizens of other states, approved in Washington, on 18 March 1965.

3. Every decision of international arbitration according to this article is final and irrevocable for the parties in dispute. The Republic of Albania undertakes to apply without delay the provisions of these decisions and assure their implementation within its territory.

Article 9

The status of this law

1. Law no. 7594, dated 04.08.1992 "For foreign investments" and all other legal provisions or substatutory acts contrary to this law are abrogated.

2. In case the provisions of this law are not in conformity with international agreements ratified by the People's Assembly to which the Republic of Albania and the Government of the Republic of Albania is a party, the latter will prevail to the extent they provide rights or greater protection for foreign investors than those provided by this law.

Article 10

National security

Nothing in this law shall prevent the application by the Republic of Albania of the necessary measures for the protection of public order, fulfillment of its international obligations regarding the establishment and preservation of peace and security all over the world, protection of national security or defense interests.

Article 11

Publication of laws

The Republic of Albania will publish all laws, rules and procedures regarding foreign investments.

Article 12

Entering into force

This law enters into force 15 days after publication in the Official Journal.

Proclaimed by decree no. 687, dated 10.11.1993 of the President of the Republic of Albania, Sali Berisha.

APPENDIX B

CROATIAN INVESTMENT LAW

(The English translation of the Croatian Investment Law can been found on the Croatian National

Bank website: http://www.hnb.hr/propisi/zakoni-htm-pdf/ezakon_o_pu.pdf)

INVESTMENT PROMOTION LAW

I - GENERAL PROVISIONS

Article 1

(1) This Law regulates the promotion of investments of Croatian and foreign legal or physical persons with the aim to stimulate economic growth, development and implementation of the economic policy of the Republic of Croatia, its integration into international trade through increase of export and competitiveness of the Croatian economy.

(2) For the purpose of this Law, the investment promotion shall comprise a system of incentive measures, tax and tariff privileges.

(3) The incentive measures, tax and tariff privileges regulated by this Law apply to the investments in economic activities, if those investments provide for environmentally friendly activities and if they meet one or more of the following objectives:

- Introduction of new equipment and modern technologies,
- Introduction of new production processes and new products,
- Employment and education of employees,
- Modernisation and improvement of business,
- Development of production with higher degree of processing,
- Increase of export,
- Increase of economic activities in the parts of the Republic of Croatia where economic growth and employment fall behind the state average,
- Development of new services,
- Saving of energy,
- Improvement of information activities,
- Co-operation with foreign financial institutions,
- Adjustment of Croatian economy to European standards.

Article 2

For the purpose of this Law, the expressions shall have the following meanings:

1. *Investor:* Croatian or/and foreign legal or physical person or few of them together who invest at least four million kunas into the beneficiary of incentive measure, tax and tariff privilege.

2. *Investment:* the value of assets, rights and liabilities determined in compliance with IAS, entered as the ownership of the beneficiary of incentive measures, tax and tariff privileges.

3. *Beneficiary of incentive measures, tax and tariff privileges:* companies taking advantage of incentive measures, tax and tariff privileges. Tax and tariff privileges may be given only to the beneficiary of incentive measures, tax and tariff privileges registered as a newly established company which is registered for the exclusively for the activities that they are granted the tax and tariff privileges for.

Exceptionally, if the investment in tourist activity is concerned, subject to an application by the investor and proposal of the Ministry of Tourism, the Government of the Republic of Croatia may decide that the already existing company is the beneficiary of incentive measures, tax and tariff privileges.

4. *Ministry*: Ministry of Economy as the ministry in charge of the activities related to investment promotion.

II - INCENTIVE MEASURES

Incentive measures

Article 3

The incentive measures shall include:

1. Leasing, granting of construction rights, sale or usage of real estate or other infrastructure facilities under commercial or more favourable conditions, including without a fee, notwithstanding the provisions of Article 391 of the Law on Property and Other Rights in Rem and Article 6 of the Law on the Lease of Business Premises, Real Estate and Facilities Owned by the Republic of Croatia, local government or self-government units, or real estate from the portfolio of the Real Estate Fund for the Promotion of Investment.
2. assistance granted for the new job creation,
3. assistance granted for the vocational training or re-training.

Assistance granted for the new job creation, vocational training or re-training

Article 4

(1) The beneficiary of incentive measures, tax and tariff privileges who creates new jobs and new employment may be granted the amount up to 15,000 kunas per employee for covering the cost of job creation by the Fund for the Stimulation of New Job Creation and Re-training of Employees on a one-time basis.

(2) The incentive under paragraph 1 above applies only to new job creation under condition that the number of new employees is not reduced during the period of three years at least.

(3) For the purpose of this Law, when calculating the number of newly created jobs the number of jobs abolished in other companies of the investor, which are in relation to the investment of the investor shall be taken into the consideration.

(4) If the employer invests in vocational education or re-training of his employees, the Fund for the Stimulation of New Job Creation and Re-training of Employees may participate with up to 50% in covering of the costs of the vocational education or retraining.

(5) The participation in covering of the costs specified in paragraphs 1 and 4 above shall be in the form of non-repayable funds or soft-loan granted by the Fund for Stimulation of New Job Creation and Re-training of Employees.

(6) The Fund for Stimulation of New Job Creation and Re-training of the Employees decides on the incentive measures on the proposal of the Ministry of Labour and Social Welfare.

Incentive funds

Article 5

(1) The establishment and activities of the Real Estate Fund for the Promotion of Investment and the Fund for Stimulation of New Job Creation and Re-training of Employees will be determined in a separate law.

(2) Before the Funds under paragraph (1) are established, the Ministry and other authorised body as the Privatisation Fund shall grant the incentive measures from real estates and resources, and contracts that the Government of the Republic of Croatia or other authorised body disposes of pursuant to laws and other regulations.

(3) The priority in granting of incentive measures shall be given to companies in majority ownership of Croatian legal and physical persons.

(4) The bodies under paragraph 2 above which grant incentive measures are obliged to keep records of those grants; the minister of finance shall stipulate the content and form thereof.

III - TAX AND TARIFF PRIVILEGES

Tax privileges

Article 6

(1) For investments exceeding the amount of 10 million kuna, profit tax rate will be 7% for a period of 10 years as from the first year of the investment, under condition that not less than 30 employees are employed in that period beginning with the first year of the investment.

(2) For investments exceeding 20 million kuna, profit tax rate will be 3% for a period of 10 years as from the first year of the investment, under condition that at least 50 employees are employed in that period beginning with the first year of the investment.

(3) For investments exceeding 60 million kuna, profit tax will rate be 0% for a period of 20 years as from the first year of the investment, under condition that at least 75 employees are employed in that period beginning with the first year of the investment.

(4) The total amount of the tax privilege that the investor is entitled to during the period of the application of the preferential profit tax rate may not exceed the value of the investment itself. This amount is determined as absolute amount of the difference between the due amount of the profit tax calculated pursuant to the Profit Tax Law and the amount calculated pursuant to this Law.

(5) If the beneficiary of incentive measures, tax and tariff privileges reduces the number of employees determined in the provisions of Article 4 above and paragraphs 1, 2 and 3 above, the right to use the privileges concerned ceases for the whole period granted and he is obliged to repay the funds derived from the privileges granted together with the interest.

(6) The beneficiary of incentive measures, tax and tariff privileges whose right to use the privileges ceased may not be granted those privileges again.

Structure of investments

Article 7

The part of the investment which comprises land, buildings aged more than one year, and already used equipment, invested as a share of the investment shall not be treated as a part of investment under Article 2, item 1 and Article 6, paragraphs 1, 2 and 3.

Tariff privileges

Article 8

When the equipment which is a part of the investment is imported, the customs duty does not apply to goods under Chapters 84, 85 86 and 87 (except motor vehicles of a cylinder capacity exceeding 1500 m3), 88, 89 and 90 of the Tariff Law.

Article 9

When the investment of special economic interest for the Republic of Croatia is made, the Government of the Republic of Croatia may increase the amount of incentive measures, tax and tariff privileges stipulated in this Law and extend the delay for the transfer of losses of the previous accounting period after the proposal of the authorised ministry taking into account the importance of investment for the overall economic development and employment, equal regional development, the development of the less developed areas and the development of the economic sector in which the investment has been made.

Article 10

(1) Legal and physical persons who intend to submit an application for the incentive measures, tax and tariff privileges pursuant to this Law have to inform the Ministry and the Ministry of Finance - Tax Administration in writing on the manner, kind and amount of incentive measures, tax and tariff privileges.

(2) On the basis of this prior information, the Ministry, together with the Ministry of Finance and other ministries in charge of the investment concerned, shall assess whether such an investment is eligible for incentive measures, tax and tariff privileges. The applicant shall be informed on the standpoint in 30 days from the date of the reception of the prior information.

(3) The beneficiaries of incentive measures, tax and tariff privileges are obliged to submit an annual report in writing to the Ministry and Ministry of Finance - Tax Administration during the period those measures and privileges are used.

(4) The annual report under paragraph 3 above is submitted before the end of March of the current year for the previous calendar year.

(5) If the beneficiary of incentive measures, tax and tariff privileges does not submit the report in the period specified under paragraph 4 above, its right to use the incentive measures and privileges ceases.

(6) The obligatory content of the report under paragraph 1 and 3 above will be stipulated in the Decree adopted by the Government of the Republic of Croatia.

(7) If necessary, the Ministry of Finance - Tax Administration is entitled to control and inspect the usage of incentive measures, tax and tariff privileges with the beneficiary of incentive measures to detect and penalise irregularity and illicitness.

IV - PENALTY CLAUSE

Penalty clause

Article 11

(1) The beneficiary of incentive measures, tax and tariff privileges shall be fined with 100.000,00 kuna to 1.000.000,00 kunas if he:

- does not use the incentive measures, tax and tariff privileges in compliance with the provisions of Article 4, 6 and 8 of this Law,
- does not submit an annual report in writing to the Ministry and Ministry of Finance - Tax Administration in compliance with the provisions of Article 10 of this Law.

(2) The responsible person of the beneficiary of incentive measures, tax and tariff privileges shall also be fined for violation under paragraph 1 above with 10.000,00 to 100.000,00 kunas.

V - TRANSITIONAL AND FINAL PROVISION

Article 12

(1) The Government of the Republic of Croatia undertakes the obligation to adopt the Decree under paragraph 6 of Article 10 above within 60 days of the date this Law enters into force.

(2) The minister of finance undertakes the obligation to adopt the regulation under paragraph 4 Article 5 within 60 days of the date this Law enters into force.

(3) The minister of finance is authorised to adopt other regulations for the implementation of this Law if necessary.

Article 13

This Law shall enter into force on the eighth day following its publication in the "Official Gazette".

Class: 404-01/00-01/02

Zagreb, 12th July 2000

HOUSE OF REPRESENTATIVES
OF THE CROATIAN STATE PARLIAMENT

President of the House of Representatives
of the Croatian State Parliament
Zlatko Tomcic, signed