LEGAL ISSUES IN TRADE AND INVESTMENT

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International law and institutions are necessary to foster welfare enhancing international trade and investment activities. These laws and mechanisms fall into two main categories, private international trade law and public international trade law, although there is significant overlap between the categories. Private trade law deals with the rights and obligations of international traders and investors vis-a-vis each other. Here there is a need for mechanisms to resolve conflicts of laws between persons from different legal systems. There is also value in promoting harmonization initiatives to reduce the transaction costs of trade between persons from different legal cultures. Where public international trade law is concerned there is a need to develop an appropriate compromise between the sovereign rights of nation states and the desirability of co-operative behavior between them. Here there is a particular need to identify processes and mechanisms to promote the normative effect of international rules, given the lack of any coercive power over nation states. Inadequate and inefficient laws and mechanisms will be a disincentive to productive trade and investment.

1. Introduction

Economic theory postulates that international trade and investment based on free market principles will permit scale economies, promote international competition, and increase world welfare (see *International Economics and Finance*). As with any market system, legal rules and institutions are required to promote beneficial exchange by establishing certain legal rights and entitlements and by encouraging compliance with obligations. If the legal system is sub-optimal, it will detract from the prospective economic gains that ought to be made.

If the inadequacies are extreme, there could be a complete disincentive to such productive endeavors. In addition, faults of the legal system may be wrongly attributed to trade theory, hence impacting upon the acceptance of welfare enhancing domestic and international policies. Where private traders are concerned, the most significant legal requirements are effective systems of property rights and contract laws. These provide the building blocks in relation to market-based exchange. These rights need to be supported by dispute settlement mechanisms to deal with conflict and enforcement of those rights where necessary.

There are a number of important related legal regimes. For example, corporations law provides a legal mechanism for collective productive activity. It delineates the optimal features where there is separation of management and control and where a separate legal entity is placed between owners and third parties. Finance law provides mechanisms to allow for productive activity based on debt financing.

Elements include the utilization of security rights where appropriate to support the base loans and the establishment of secondary markets where finance rights and obligations can be traded. Insurance law allows for the risks from trade and investment to be spread. Agency law allows parties to be legally represented by other persons. Insolvency laws seek to ensure that non-viable persons and corporations are prevented from further trading, while at the same time, allowing parties involved in one failed venture, an opportunity to engage in distinct future transactions.

There are also a range of governmental rules and regulations that not only support the basic market mechanism but which also seek to modify market behavior. Governmental rules which aim to alter or control market outcomes are seen as justified where they deal with market imperfections such as anti-competitive behavior. Here we have competition or anti-trust laws to deal with inefficient outcomes such as monopolies that can be expected to arise from time to time under market systems. Environmental regulation is also seen as necessary to deal with negative externalities that are not factored into prices by market traders.

Governmental rules also deal with taxation. These could be limited to revenue raising. More often they are also aimed at providing incentives and disincentives for different forms of economic activity. This commonly occurs even though economic theory would argue against most such initiatives. Other fields of endeavor see government intervention in order to promote certain market outcomes. For example, governments impose certain controls on labor markets for mixed reasons.

2. International Trade and Investment and Legal Infrastructure

While the fields of labor and taxation are contentious, most of the other rules and mechanisms are not. In this sense they are also needed in the international arena if productive exchange is to be supported. Often the need for rules and mechanisms is greater in the international arena because of the greater level of risk and uncertainty. Key transaction costs of international trade include uncertainty and risk as to the nature and identity of foreign trading partners and their commercial and legal cultures, the physical risks of international transport of goods, the risk of differentials in intellectual property protection between jurisdictions, problems of proof in relation to damage caused to or by goods where there have been multi-modal forms of transport, security over goods and payment for goods, and the political stability or otherwise of host countries in terms of direct foreign investment.

While the need for such mechanisms is clear, there are significant difficulties in seeking to replicate at the international level common features of domestic legal systems. The first problem is the lack of an international legislative mechanism that can deal with such policy issues. Instead, it is necessary for there to be some inter-governmental co-operation to build appropriate institutions and principles. Here there are a range of approaches all with varying strengths and weaknesses. These initiatives range from establishing binding international rights and obligations to at the other extreme, promoting familiarity with other legal systems with a view to minimizing uncertainty and risk. International initiatives can take the form of multilateral treaties, bilateral agreements, model laws offered by international institutions for adoption at the domestic level, statements of principle, explanatory guides, and standard terms and conditions open to be adopted by parties.

The second problem has been the need to find optimal mechanisms to deal with the unique difficulties occasioned by international as opposed to domestic trade and investment. International economic law seeks to develop mechanisms to minimize such distinct transaction costs and promote the welfare enhancing effects of international trade.

The first difference between domestic and international transactions is the fact that there are usually a wider range of parties and hence legal relationships. There may then be demarcation problems in defining rights and obligations. This may lead to potential overlap and problems of proof where disputes arise. There are a number of contractual relationships that often apply in any typical transaction. Where trade is concerned, the first is the contract of sale for goods or services between the buyer and the seller. If it is a sale of goods, the next would be a contract of carriage between the consignor and the carrier. There may a range of related contracts where multi-modal transport is involved. The third would be a contract of insurance. The fourth would be a contract between the buyer and its bank issuing some form of documentary payment mechanism. The fifth would be a contract between the banks and the seller to facilitate transfer of the funds.

The international nature of such a transaction prevents any natural way for traders to approach the establishment of mutually beneficial rights and obligations. For example, where payment is concerned, a buyer would not normally wish to pay for goods without being able to inspect them in the importing country to see that they have arrived safely and in good quality and condition. Yet the seller would not normally wish to ship goods to a foreign jurisdiction without some assurance of payment. The legal system has had to develop mechanisms that overcome this disincentive and provide appropriately balanced rights and obligations.

Transfers of funds across national boundaries involve a legal infrastructure combining international arrangements with local laws. Specialized contract laws determine the rights and obligations of payer, payee and the various banks in the chain of transactions used to facilitate international trade. Regulatory issues include tracing of misappropriated funds, fraud generally, confidentiality, and security mechanisms. There is also a need to ensure that legal mechanisms and institutions keep pace with electronic forms of trade and finance.

Rules and principles need to determine who bears the risk of loss during the often lengthy period of transport and who has title to the goods in order to deal with them further. A legal fiction has developed where the transport documents are treated as title to the goods. Payment is made on transfer of appropriate title documents and not proof of quality of the goods themselves. Documentary letters of credit and similar financial instruments deal with the problems of security over payment. The parties invariably use banks as intermediaries or facilitators of the payment. Inter-bank obligations to make payments as per their contract commitments would be frustrated if they became embroiled in any dispute between the parties as to the quality of the goods. This again is overcome by treating the transaction as a dealing in the legal documents rather than the physical goods.

While such mechanisms have been developed, there are many uncertainties that remain. Some of these legal rules are international, emanating from multilateral agreements.

Most are domestic in origin. Where the latter are concerned there may be significant differences in approach between trading nations.

3. Foreign Investment

Most of the above issues and problems also arise in the field of foreign investment. In addition, there are very sensitive political and philosophical issues involved that are hard to regulate through legal mechanisms. One problem is the relatively recent phenomenon of foreign direct investment. This has become more important as the twentieth century has progressed. Initially it was generally seen as a matter of domestic policy. Public international law imposed little in the way of restrictions on that policy. Nevertheless, there were tensions. Where customary international law is concerned, on the one hand the principle of territorial sovereignty means that nation states can control foreign investment within their own borders. On the other hand, the principle of nationality recognizes that each state has an interest in the way its own nationals and their property rights are treated in foreign jurisdictions.

A combination of these principles in the field of foreign direct investment has led to the two key propositions of no expropriation without compensation and free movement of funds. The Resolution on the Charter of Economic Rights and Duties of States recognizes that each state has the right to regulate foreign investment.

This right includes the right "to nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the state adopting such measures. ..." It is a topic of debate whether any such compensation should merely be adequate or should be "full, prompt and effective." There is consensus that expropriation should not be undertaken in a discriminatory manner.

There were a number of constraints on a more integrated international regime. Debates as to the benefits or otherwise of foreign investment were of particular relevance to socialist and developing country economies. Many countries either restricted foreign investment or placed significant controls and restrictions over such behavior. Rules vary depending on the industry involved. Many countries operated screening mechanisms although these are diminishing over time.

More recently, countries have sought to promote foreign investment. In doing so they have sought to remove restrictions, provide appropriate guarantees for foreign investors and in many cases, offer inducements.

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Biographical Sketch

Jeff Waincymer is Professor of Law and Director of Research in the Faculty of Business and Law at Deakin University in Melbourne, Australia. He has published books in the field of WTO litigation, international trade law, international commercial arbitration, and taxation. In addition to teaching and researching in the fields of international economic law, arbitration, and taxation, he has been a consultant to government on related law reform measures and has acted as a panelist on an intergovernmental World Trade Organization dispute. In addition he is currently Chair of the International Trade and Business Committee of the Law Council of Australia.