Foreign direct investment in Venezuela

Colin Forbes
Faculty of Law –Institute of Comparative Law
McGill University, Montreal
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Abstract

This paper analyzes the liberalization of Venezuela's foreign direct investment (FDI) laws. In the past, Venezuela placed tough restrictions upon the entry and operation of foreign investment. These restrictions were made possible as long as petroleum prices remained high and the country had access to cheap international bank loans. The debt crisis in the 1980s, a drop in commodity prices, and a decrease in international bank loans once again made FDI an attractive source of foreign capital. In order to attract greater FDI inflows, Venezuela began to liberalize its foreign investment laws in the mid-1980s. Despite these changes, FDI inflows into Venezuela have been erratic. This paper then discusses some of the adjustments Venezuela will have to make in order to attract greater foreign investment inflows, and ends with an examination of how the country can maximize FDI's contribution to its economic development.

Résumé

Ce mémoire analyse la libéralisation des lois vénézuéliennes portant sur l'investissement direct étranger (IDE). Le Venezuela avait auparavant mis en place des restrictions sévères à l'entrée et aux opérations des investissements étrangers. Ces restrictions étaient possibles aussi longtemps que le prix du pétrole restait élevé et que le pays avait accés à des emprunts bancaires internationaux bon marché. La crise de la dette des années 80, la chute du prix des matières premières et la réduction du nombre d'emprunts bancaires internationaux ont rendu le IDE une source intéressante de capitaux étrangers. Afin d'attirer un flux de IDE plus élevé, le Venezuela a entrepris dans le milieu des années 80 la libéralisation de sa législation sur l'investissement étranger. En dépit de ces modifications, le flux de IDE au Venezuela a été erratique. Ce mémoire discute de certains ajustements que le Venezuela devra effectuer afin d'attirer des flux plus importants de capitaux étrangers, et se conclu par un examen de la manière don't le pays pourrait augmenter la contribution de IDE à son développement économique.

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List of Abbreviations

ANCOM – Andean Common Market
BITs – Bilateral Investment Treaties
Conapri – Consejo Nacional de Promoción de Inversiones
CVP – Corporación Venezolana de Petróleos
DTTs – Double Taxation Treaties
ECLAC – Economic Commission for Latin America and the Caribbean
FDI – Foreign Direct Investment
GATS – General Agreement on Trade in Services
GDP – Gross Domestic Product
ICSID – International Centre for Settlement of Investment Disputes
IMF – International Monetary Fund
LAFTA – Latin American Free Trade Association
MAI – Multilateral Agreement on Investment
MFN – Most Favored Nation treatment
MNE – Multinational Enterprise
OECD – Organization for Economic Cooperation and Development
OPEC – Organization of Petroleum Exporting Countries
Procompetencia – Superintendencia para la Promoción y Protección de la Libre Competencia
SIEX – Superintendencia de Inversiones Extranjeras
TRIMs – Agreement on Trade-Related Investment Measures
UNCITRAL – United Nations Commission on International Trade Law
UNCTAD – United Nations Conference for Trade and Development
UNESCO – United Nations Education, Scientific and Cultural Organization
WTO – World Trade Organization

I. Introduction

Foreign direct investment (FDI) is an investment involving a long-term relationship and control of an enterprise in one economy (affiliate enterprise or foreign affiliate) by an enterprise located in another country (foreign direct investor or parent enterprise).[1] FDI differs from foreign portfolio investment in that in the latter an investor acquires securities in a foreign company solely to earn a financial return, but with no interest in controlling or participating in the management of that enterprise.[2] The dividing line between these two types of investments is generally considered to be a 10% equity stake.[3] With investments equal to or above that amount considered to be direct investments, and investments below that amount considered to be portfolio investments.

Over the last few years there has been an incredible growth in FDI. From 1993 to 1998, global FDI inflows (the amount of FDI that flows into countries) nearly tripled, going from approximately $219 billion to $644 billion in 1998.[4] In 1998 alone, despite gloomy economic conditions prevailing in the world's economy, FDI inflows grew by roughly 39%.[5] The majority of this increase was concentrated in developed countries. In 1998, FDI inflows into these countries reached a record $460 billion (a 68% increase from 1997) and their share of global FDI inflows grew from 59% to 72%.[6] One of the

[1] UNCTAD, *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development* (United Nations: New York and Geneva) United Nations publication, Sales No. E.99.II.D.3. at 465 [hereinafter *World Investment Report 1999*].
[2] M.J. Trebilcock & R. Howse, *The Regulation of International Trade* (London and New York: Routledge, 1995) at 274.
[3] The most typical example a foreign direct investment being the establishment of a fully-owned (100% equity stake) by a foreign company. IMF, *Balance of Payments Manual*, 5th ed. (Washington: IMF, 1993) at 86.
[4] *World Investment Report 1999*, *supra* note 1 at 477.
[5] *Ibid.* at 11.
[6] *Ibid.* at 34.

main reasons behind the noticeable increase in FDI into these countries was the impressive wave of mergers and acquisitions (M&As) that took place between firms located in these countries.[7] In 1998, the value of these deals was an astounding $544 billion, an increase of $202 billion over the previous year.[8] The largest of these deals was the acquisition of Amoco (U.S. company) by British Petroleum for an estimated $55 billion.[9]

In contrast to developed countries, FDI inflows into developing countries declined in 1998. After reaching an all-time high of $173 billion in 1997, FDI inflows into these countries fell to $166 billion, a four per cent decrease.[10] In large part this decline was the result of lower FDI inflows into Asian countries. In 1998, the share of Asian countries in total FDI inflows to developing countries dropped from 55% to 51% in 1997 ($95.5 billion compared to $84.9 billion).[11] The share of Latin American and Caribbean countries in total FDI inflows to developing countries, on the other hand, increased from 40% in 1997 to 43% in 1998 ($68.3 billion to $71.7 billion).[12]

The large increase in FDI flows is commonly cited as evidence of the growing inter-relationship of the world's economy (a phenomenon commonly referred to as globalization).[13] FDI now outweighs trade in goods and services as the predominant mode of servicing foreign markets. In 1998, the total value of sales of foreign affiliates

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[7] *Ibid.* at 11. Other factors that also fueled the increase of FDI into these countries was the continuous economic growth experienced by the United States and several EU countries. This in contrast, to the economic recession plaguing a number of developing countries, most noticeably countries in the Asian region. *Ibid.* at 34.
[8] *Ibid.* at 11.
[9] *Ibid.*
[10] This was the first time in thirteen years that FDI inflows into these countries have declined. *Ibid.* at 45.
[11] *Ibid.* at 479.
[12] *Ibid.* at 478.
[13] UNCTAD, *Foreign Direct Investment and Development, UNCTAD Series of Issues in International Investment Agreements* (New York and Geneva: UNCTAD, 1999) United Nations publications, Sales No.E.98.II.D.15. at 49 [hereinafter *UNCTAD Series*].

($11 trillion) exceeded world exports ($7 trillion).[14] This is a trend that has remained constant since the early 1980s.[15] Unlike trade in goods and services, however, FDI represents "deep integration" of the world economy because it represents integration at the production level and not the mere transfer of goods and services.[16] Integration through FDI itself is increasingly becoming deeper as more firms now pursue complex integration strategies.[17] Under a complex integration strategy a firm locates each production activity where the cost-productivity combination is the most favorable in terms of achieving the highest profitability for the firm as a whole.[18]

The dramatic increase in FDI over the last decade would not have been possible without a remarkable change in developing countries' attitudes towards foreign investment.[19] Perhaps in no other region has this change been more striking than in Latin America.[20] For a large part of the past century, these countries held a great deal of resentment towards foreign investment and the activities of multinational enterprises (MNEs)[21] in their territories.[22] During the 1960s and 1970s, this hostility was reflected in tough foreign investment laws which stopped just short of prohibiting this type of

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[14] *World Investment Report 1999, supra* note 1 at 14.
[15] *Ibid.*
[16] *UNCTAD Series, supra* note 13 at 6.
[17] *Ibid.* at 5-6.
[18] *Ibid.*
[19] *Ibid.* at 9.
[20] M.R. Agosin, ed., *Foreign Direct Investment in Latin America* (Washington, D.C.: Inter-American Development Bank, 1995) at 10.
[21] *Ibid.* A multinational enterprise (MNE) can be defined as a firm that controls assets and engages in the production of goods and services in more than one country. *UNCTAD Series, supra* note 13 at 5.
[22] From the 1940s until the 1980s, the "dependency theory" dominated political and economic thought throughout Latin America. According to this theory, the global economy was set up in such a way that it always favored a group of central States (developed countries) to the detriment of the peripheral States (developing countries). Therefore, the rich central states always grew richer while the poor peripheral states became poorer. In this scheme, MNEs and foreign investment just served to exploit developing countries and to perpetuate their state of dependency. See: D. Yergin & J. Stanislaw, *Pioneros y Lideres de la Globalización,* trans. D. Placking (Buenos Aires: Javier Vergara Editor, 1999) at 355.

investment in the region.[23] The debt crisis in the 1980s, however, forced a radical reappraisal in these countries' economic policies and ushered in a new era in Latin America, the era of free market economics.[24] The resulting change in ideology has created an environment which is much more hospitable towards foreign investment. Consequently, all countries throughout the region have now liberalized their foreign investment laws and are now making an active effort to attract this type of investment.[25]

This paper will concentrate on the liberalization of Venezuela's[26] FDI laws. Since 1914, the petroleum industry has typically been the main destination for FDI in Venezuela.[27] This was only logical given the country's vast oil reserves.[28] In the 1960s, however, significant amounts of FDI began to flow into Venezuela's manufacturing sector due to the protection offered by the country's import-substitution strategy.[29] During this period of time, with the exception of the oil industry, Venezuela generally

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[23] See: E.R. Carrasco, "Law, Hierarchy, and Vulnerable Groups in Latin America: Towards a Communal Model of Development in a Neoliberal World" (1994) 30 Stanf. J. Int'l L. 221 at 235. See also: I. De Leon, "The Role of Competition Policy in the Promotion of Transnational Investments in a Global Market Economy""(1997) http://www.procompetencia.gov.ve/transnationalinvestments.html (date accessed: 12 April 2000) at 2.

[24] See: A.J. Jatar, "Políticas de Competencia en Economías Recientemente Liberalizadas: El Caso de Venezuela" (1993) http://www.procompetencia.gov.ve/politicascompetenciavenezuela.html (date accessed: 12 April 2000) at 1-2.

[25] See: Agosin, *supra* note 20 at 10.

[26] Conapri, *Venezuela: Now* (Caracas: Conapri, 1997) at 4. Venezuela is located at the northeastern tip of South America. The country is limited on the north by the Caribbean Sea, to the south by Brazil, to the east by Guyana, and to the west by Colombia. The country has approximately 912,050 km2.

[27] See: J.A. Mayobre, *Las Inversiones Extranjeras en Venezuela* (Caracas: Monte Avila Editores, 1970) at 31.

[28] Conapri, *supra* note 26 at 4. Venezuela's possesses the sixth largest reserves of light crude in the world and the largest reserves of heavy crudes.

[29] See: J.O. Rodner, *La Inversión Internacional: En Países en Desarrollo* (Caracas: Editorial Arte, 1993) at 61. The import-substitution model of development can be traced back to the 1930s and 1940s, but the theory became popular in the 1950s under the auspices of Raul Prebish and the United Nations Economic Commission for Latin America (ECLA, now Commission for Latin America and the Caribbean (ECLAC)). According to this theory, developing countries would continue to be vulnerable to the constant fluctuations of the global economy as long as they continued to be commodities producers. In order to limit this dependence, developing countries would have to replace imported manufactured products with domestically produced goods. In the early stages of this strategy, high-tariff barriers would be necessary in order to protect infant domestic firms. See: Carrasco, *supra* note 23 at 228-235.

placed no restrictions upon foreign investment.[30] FDI legislation was only implemented in the 1970s as a result of Venezuela's accession into the Andean Common Market (ANCOM, now called the Andean Community of Nations) in 1973,[31] and the promulgation of Decision 24 the following year.[32] In 1976, Venezuela also nationalized its oil industry. The harsh conditions imposed by Decision 24 and restrictions upon foreign investment in the oil industry subsequently led to a reduction in FDI inflows.[33] This was not a problem in the 1970s since Venezuela enjoyed large oil revenues and had access to cheap international loans. The onset of the debt crisis and a drop in commodity prices in the 1980s, however, forced the country to reappraise its strategy.[34] Faced with a shortage of capital, foreign investment once again became an attractive source of external capital for Venezuela. Beginning in the mid 1980s, the country began to liberalize its FDI laws in order to attract greater amounts of foreign investment.[35] The liberalization of Venezuela's FDI laws has generally meant a removal in the majority of restrictions upon the entry and operation of foreign enterprises and a strengthening in the standards of treatment offered to these enterprises.

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[30] Mayobre, *supra* note 27 at 83.

[31] The Andean Common Market was born on May 26, 1969 through the signing of the Cartagena Agreement by Colombia, Ecuador, Chile, Peru, and Bolivia. Venezuela entered ANCOM on February 13, 1973 by signing the Consensus of Lima. Chile would withdraw in 1976. R.J. Radway & F.T. Hoet-Linares, "Venezuela Revisited: Foreign Investment, Technology, and Related Issues" (1982) 15:1 Vand. J. Transnat'l L. 1 at 12. As of June 3, 1997, through the Protocol of Trujillo, ANCOM officially changed its name to the Andean Community of Nations. See: *Decision 406* http://www.comunidadandina.org/NORMATIVA/DEC/D406.HTM (25 June 1997).

[32] Decision 24 was ratified by ANCOM's original members in December, 1970, and only became effective in Venezuela on January 1, 1974. See: *Ley Aprobatoria del Acuerdo de Integración Subregional o Acuerdo de Cartagena y de las Decisiones 24, 37, 37-A, 40, 46 y 70 de la Comisión del Acuerdo de Cartagena*, Gaceta Oficial Extra. 1620, November 1, 1973. For a translation of Decision 24 see: *Decision 24-Common Regime of Treatment of Foreign Capital and of Trademarks, Patents, Licenses, and Royalties* (1972) 11 I.L.M. 126 [hereinafter *Decision 24*].

[33] See: R.J. Radway, "Venezuela: Certain Legal Considerations for Doing Business" (1976) 8 Case W. Res. J. Int'l L. 289 at 301.

[34] See: Radway & Hoet-Linares, *supra* note 31 at 43.

[35] See: Leon, *supra* note 23 at 4.

Despite the changes in Venezuela's foreign investment legislation, FDI flows into the country have not been impressive.[36] The only two years in which the country experimented an impressive growth in FDI inflows were in 1996 and 1997 as a result of the opening of the country's oil industry to foreign investors.[37] In 1997, FDI inflows grew by an astounding 133% reaching $5.087 billion.[38] Since then, however, FDI inflows have steadily declined falling to $3.737 billion in 1998,[39] and to $2.7 billion in 1999.[40] The decline of FDI inflows into Venezuela contrasts with an increase in foreign investment flows into Latin America over the last couple of years.[41] One of the main reasons for the decline in FDI inflows has been the country's unstable political and economic situation.[42]

This paper will examine how Venezuela can reverse this trend, and how it can extract the maximum benefits from FDI. In a more liberalized setting in which more countries are competing for FDI, the simple liberalization of FDI laws will not be sufficient to attract FDI inflows.[43] Attracting greater FDI inflows in today's competitive global economy requires not only that countries liberalize their foreign investment laws, but also that they create a favorable investment climate. At the same time, governments

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[36] ECLAC, *Foreign Investment in Latin America and the Caribbean: 1998 Report* http://www.eclac.org/espanol/Publicaciones/inver98/index.htm (date accessed: 6 June 1999) at 120 [hereinafter *ECLAC 1998 Report*].

[37] *Ibid.*

[38] *Ibid.*

[39] *World Investment Report 1999, supra* note 1 at 478.

[40] F.Williams, "Latinoamérica Supero a Asia como Receptor de Inversión Foránea", *El Universal* trans. J.Peralta (2 February 2000) at 2-8.

[41] According to UNCTAD estimates, in 1999, FDI inflows into Latin America grew by approximately 32% reaching a record $97 billion. *Ibid.*

[42] *Ibid.*

[43] UNCTAD, *World Investment Report 1998: Trends and Determinants* (New York and Geneva: United Nations), United Nations publication, Sales No. E.98.II.D.5. at xxvii [hereinafter *World Investment Report 1998*].

have to keep in mind that their principal objective in attracting FDI is to promote the economic development of their countries.[44]

This paper will be divided into six sections. This introductory section is followed by Section II which examines the costs and benefits of FDI. Section III will look at the history of foreign investment in Venezuela and the evolution of its FDI legislation. Sections IV and V, respectively, will examine how Venezuela can improve its overall investment climate and how the country can maximize FDI's contribution towards its economic development. Section VI will be the concluding remarks.

[44] See: UNCTAD, *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy* (New York and Geneva: United Nations), United Nations publication, Sales No. E.97.II.D.10. at xvii. The majority of contemporary development theories consider that economic development comprises not only economic growth, but also a more equal distribution of wealth. See: K.J. Vandevelde, "Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties" (1998) 36 Colum. J. Transnat'l L 501 at 514.

II. Costs and Benefits of FDI

Before initiating our discussion on the costs and benefits of FDI, let us digress briefly and examine some of the reasons why this type of investment occurs. When considering servicing foreign markets, a firm has a variety of options available to it.[45] A firm may decide to export from its production facilities at home, it may license to a foreign firm,[46] it can establish franchises abroad,[47] it may export its technology abroad through turnkey projects,[48] or it may decide to establish its own production facilities abroad, in which case it undertakes FDI.[49] Why do firms establish production facilities abroad when the other methods are generally less costly and involve less risk? This question has been debated by experts for over forty years.[50] There is now, however, a great deal of consensus that FDI takes place as a result of three interacting circumstances.[51] This idea which was first proposed by British economist John H. Dunning is called the "OLI" or "eclectic" explanation to foreign investment.[52] First, FDI takes place when firms possess valuable intangible assets (i.e. technology, brand names,

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[45] C.W. Hill, *International Business: Competing in the Global Marketplace*, 2nd ed. (Chicago: Richard D. Irwin, 1997) at 413.

[46] A licensing agreement may be defined as "an arrangement whereby a licensor grants the right to intangible property to another entity (the licensee) for a specific period of time, and in return, the licensor receives a royalty fee from the licensee." *Ibid.* at 407.

[47] Franchising "is basically a specialized form of licensing in which the franchisor not only sell the intangible property to the franchisee, but also insists the franchisee agree to abide by strict rules as to how it does business." *Ibid.* at 409.

[48] In a turnkey project, "the contractor agrees to handle every detail of the project for a foreign client, including the training of personnel. At completion of the contract, the foreign client is handed the "key" to a plant that is ready for full operation." *Ibid.* at 406.

[49] *Ibid.* at 176.

[50] WTO, "Trade and Foreign Direct Investment" (9 October 1996), http://www.wto.org/ddf/cgi_bin/dispdoc.pl?url= (date accessed: 23 September 1998) at 12 [hereinafter *Trade and Foreign Direct Investment*].

[51] *Ibid.*

[52] For a review of the different theories of why FDI occurs see: J.H. Dunning, *Multinational Enterprises and the Global Economy* (Wokingham: Addison-Wesley Publishing Company, 1993) at 68-86.

trademarks, managerial skills), or what are called "ownership advantages", that can be exploited on a relatively large scale.[53] These "ownership advantages" allow a firm to compensate for the extra costs involved in operating production facilities in more than one country.[54] Second, it must be more profitable for production utilizing these assets to take place at a foreign location rather than producing and exporting from the home country.[55] These are what the literature calls location-specific advantages.[56] In the case of some industries like the service industry, it is pretty simple to understand why a firm needs a direct presence abroad. Unless the company has a presence in the foreign market it will not have access to its client.[57] This may also be the case when a country possesses valuable natural resources and the only way a company can access those resources is by establishing production facilities abroad.[58] Finally, in addition to possessing "ownership advantages" and being more profitable to locate production facilities abroad, in order for FDI to take place "internalization" advantages must also be present.[59] Internalization advantages exist when market imperfections (factors that inhibit markets from working perfectly)[60] make it difficult for firms to trade goods and services through arm-length transactions.[61] A typical example would be a country's imposition of high-tariff barriers upon the entry of foreign goods.[62]

Now that we have a better idea of why FDI occurs, what is the impact of this investment on the host country's economic development? There are basically three

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[53] *Trade and Foreign Direct Investment, supra* note 50 at 12.
[54] *World Investment Report 1999, supra* note 1 at 316.
[55] *Trade and Foreign Direct Investment, supra* note 50 at 12.
[56] *Ibid.* at 77.
[57] *Trade and Foreign Direct Investment, supra* note 50 at 13.
[58] *Ibid.* at 14.
[59] *Ibid.* at 12.
[60] Hill, *supra* note 45 at 185.
[61] *Ibid.* at 186.

theories that attempt to answer this question. The first, the dependency theory on foreign investment, is a theory which was very popular in Latin America and other developing countries during a large part of the last century.[63] Briefly this theory holds that "underdevelopment is perpetuated by socio-political and economic domination by a developed focal state to which the lesser developed states are peripheral."[64] As long as developing countries continued in this subservient relationship, economic development would be impossible.[65] Therefore, developing countries should seek to restrict foreign investment rather than attract it.[66] Among the negative aspects of foreign investment that this theory highlights are: the displacement of local entrepreneurs due to greater competition from foreign firms; the deterioration of the host country's balance-of payments accounts due to foreign affiliates' constant repatriation of profits; a reduction in the amount of funds available to local firms as a result of MNEs borrowing on domestic markets; the use of capital-intensive production methods in countries with an abundant labor supply; and finally, a loss of political and economic sovereignty due to foreign enterprises interference in domestic affairs.[67]

The second theory that attempts to explain the impact of FDI on the host country's economic development is the classical theory on foreign investment.[68] This theory is diametrically opposed to the dependency theory on foreign investment.

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[62] *Ibid.*
[63] This theory was rather popular in Latin America from the 1940s to the 1980s. See in this regard *supra* note 22 and accompanying text. See also: M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994) at 43.
[64] S. Horton, "Peru and ANCOM: A Study in the Disintegration of a Common Market" (1982) 17 Texas Int'l L. J. 39 at 42.
[65] See: Sornarajah, *supra* note 63 at 44.
[66] *Ibid.*
[67] T.H. Moran, *Foreign Direct Investment and Development* (Washington D.C.: Institute for International Economics, 1998) at 20-21.
[68] Sornarajah, *supra* note 63 at 38.

Proponents of this theory argue that FDI provides host countries with '"a 'package' of cheap capital, advanced technology, superior management ability, and superior knowledge of foreign markets...",[69] all of which are beneficial to the host country's economic development. Therefore, the concern of developing countries should be to attract this type of investment rather than to repel it.[70]

Finally, there is a third theory, called the "pragmatic nationalist" approach to foreign investment,[71] which attempts to find a middle-ground between the two previous theories. According to this theory, FDI can be both beneficial and harmful to the host country.[72] It is beneficial to the host country in that it provides it with a 'bundle' of assets (capital, technology, market access, management skills, and employment) which can contribute towards its economic development.[73] However, FDI can also have a negative impact on the host country's economic development through the repatriation of profits, the displacement of local entrepreneurs, and the importation of inputs by foreign affiliates.[74] Therefore, the task facing host country governments is to formulate policies which maximize the benefits of FDI while reducing its costs.[75]

In this paper we will adopt a pragmatic nationalism approach towards foreign investment. This is the theory which seems most logical in view of most of the empirical evidence available[76] and it is also the position currently adopted by the majority of

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[69] J.M. Grieco, "Foreign Investment and Development: Theories and Evidence" in T.H. Moran, ed., *Investing in Development: New Roles for Private Capital* (New Brunswick: Transaction Books, 1986) at 36.
[70] *Ibid.* at 37.
[71] Hill, *supra* note 45 at 203.
[72] *Ibid.* at 203.
[73] Grieco, *supra* note 69 at 36.
[74] Hill, *supra* note 45 at 203.
[75] *Ibid.*
[76] See: *World Investment Report 1999, supra* note 1 at 316-336.

countries.[77] This theory is also supported by such major international organizations as the United Nations Conference on Trade and Development (UNCTAD).[78] With all this being said, let us take a closer look at what are the costs and benefits of FDI.

A. Benefits of FDI

1. Capital

By definition most developing countries are characterized by low levels of savings due to the fact that the majority of the population's income is used to satisfy its basic necessities.[79] Low levels of savings in turn lead to low levels of investments, which in turn lead to low levels of productivity, which result in low wage levels.[80] Therefore, developing countries can be trapped in a vicious circle of under-development.[81] FDI can help developing countries break out of this vicious circle of under-development by helping these countries close the gap between their internal savings and the desired investment levels.[82]

Furthermore, FDI is a more stable source of external resources than other international sources such as bank loans and portfolio investments.[83] Unlike bank loans, a foreign firm is able to repatriate profits only when a project is successful. Interest on bank loans have to be paid regardless of the circumstances.[84] FDI is also a more stable

[77] Hill, *supra* note 45 at 203.
[78] *World Investment Report 1999, supra* note 1 at 316.
[79] Mayobre, *supra* note 27 at 13.
[80] Moran, *supra* note 67 at 20.
[81] *Ibid.* at 19.
[82] The relationship between savings and a country's output growth has been represented in the Harrod-Domar growth model. According to this theory, growth can represented by a equation where growth (g) equals savings (s) over capital output ratio (k) [g=s/k]. Therefore if the desired rate of output growth in 7% and the capital-output ratio is 3, then annual savings have to be equal to 21%. If savings are only equal to 16%, the remaining 5% can be compensated by FDI. M.P. Todaro, *Economic Development in the Third World*, 4th ed. (New York: Longham, 1989) at 475.
[83] *World Investment Report 1999, supra* note 1 at 161.
[84] *Ibid.*

source of capital than portfolio investments because it is normally made taking into consideration the long-term prospects of the market. Portfolio investors are normally concerned with short-term profits, and are therefore most likely to exit under adverse economic situations.[85] FDI does, however, have a major disadvantage in that it is generally a more expensive source of foreign finance.[86] In other words, profits of foreign affiliates normally tend to exceed the rate of interest of international loans, especially in developing countries.[87] The additional costs of FDI, however, in many cases might be compensated by the valuable technology a foreign investor brings to the host country.[88]

Finally, FDI may also encourage additional investments in the host country. This effect, called the "crowding in" effect of FDI (as opposed to the "crowding out" effect of FDI which we will be also examined in this paper),[89] means that other firms may be encouraged to invest due a foreign firm's investment.[90] This may be the case of other home country suppliers which follow an MNE abroad, thus leading to greater FDI inflows, or it may be the case of domestic firms that are created in order to service foreign companies.[91]

2. Technology

Technology is probably the greatest contribution FDI can make to developing countries.[92] In today's global economy, technology is a crucial factor in determining a firm's competitiveness. In order to remain competitive, firms are forced not only to

[85] *Ibid.*
[86] *Ibid.*
[87] *Ibid.*
[88] Mayobre, *supra* note 27 at 24.
[89] See in this regard *infra* note 140 and accompanying text.
[90] *World Investment Report 1999, supra* note 1 at 171.
[91] *Ibid.*

constantly improve their products, but also to find ways to reduce production costs.[93] In general, technology acts as a powerful barrier against the entry of new competitors, thereby allowing firms which operate in this segment to earn larger profits than those which specialize in labor-intensive and resource-based products.[94] The implications of this technology-driven marketplace for developing countries is that unless these countries are able to access technology or develop their own, their products will increasingly become uncompetitive on international markets.[95]

FDI constitutes the primary form of technology transfer to developing countries.[96] The diffusion of technology by foreign affiliates to the host country may be deliberate or it may take the form of technological spillovers.[97] Deliberate diffusion takes place when a foreign affiliate works directly with local suppliers in order to improve their capabilities. Technology may also be transferred in the form of spillovers when local firms, due to their interaction with foreign firms, acquire new skills. The fundamental characteristic of technological spillovers is that their benefits are unintentional and have not been planned by the MNE.[98]

A number of developing countries have been very successful in using FDI to raise domestic technological capabilities. Probably the most impressive example of a country utilizing this strategy is Singapore.[99] From the beginning, this country's goal

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[92] Mayobre, *supra* note 27 at 15. Technology is the scientific and technical knowledge which can be applied to the production of goods and services. *Supra* note 29 at 511.
[93] *World Investment Report 1999, supra* note 1 at 195.
[94] *Ibid.* at 231.
[95] UNCTAD, *Formulation and Implementation of Foreign Investment Policies* (New York: United Nations, 1992) United Nations publication, Sales No.E.92.II.A.21. at 14 [hereinafter *Formulation and Implementation of Foreign Investment Policies*].
[96] H.A. Kwon, "Patent Protection and Technology Transfer in the Developing World: The Thailand Experience" (1995) 28 Geo. Wash. J. Int'l L. & Econ. 567 at 573.
[97] *Trade and Foreign Direct Investment, supra* note 50 at 26.
[98] *Ibid.*
[99] *World Investment Report 1999, supra* note 1 at 224.

was to improve its technological capabilities by encouraging MNEs to establish technologically complex activities in their territory.[100] To this end, Singapore invested heavily in education, training, and physical infrastructure.[101] Most recently, the government has tried to encourage the creation of closer bonds between foreign affiliates and local firms; it has done this not simply by imposing domestic content requirements, but also by working closely with local suppliers in order to bring their capabilities up to foreign firms' standards.[102] These strategies have allowed Singapore to move into more technologically complex activities while investing relatively little in developing their own technology.[103]

FDI, however, is not the only means through which technology may be transferred to the host country. There are also externalized modes of technology transfer such as franchising, capital goods sales, licenses, technical assistance, subcontracting or original equipment-manufacturing arrangements.[104] Unlike Singapore, Korea and Taiwan were able to build impressive technological capabilities through externalized modes of technology transfer.[105] In both of these countries, governments invested heavily in education and technical training.[106] As domestic firms became more competitive and it increasingly became more difficult to acquire technology in externalized forms, these countries began to invest heavily in research and development (R&D) in order to produce

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[100] *Ibid.*
[101] *Ibid.*
[102] *Ibid.* at 212.
[103] S. Lall, "Changing Perceptions of Foreign Direct Investment in Development" in P.K.M Tharakan & D.van den Bulcke, eds., *International Trade, Foreign Direct Investment and the Economic Environment* (New York: St Martin's Press, 1998) at 126.
[104] *World Investment Report 1999, supra* note 1 at 203.
[105] *Ibid.* at 209.
[106] Lall, *supra* note 103 at 128.

their own technology.[107] In both cases, government played a strong role in building local technological capabilities.[108] The process of building local technological capabilities, however, took place within a strong export-oriented setting, thereby forcing domestic firms to become internationally competitive.[109]

The lessons from Singapore, Korea, and Taiwan illustrate that both internalized and externalized forms of technology transfer may be successful. A country's decision on which strategy to follow will ultimately depend on its resource endowments, political beliefs, and administrative and productive capabilities.[110] In practice, most countries have adopted a mixed strategy that tries to combine the advantages of both internalized and externalized modes of technology transfer.[111]

3. Employment

FDI can also be an important source of employment in the host country. FDI may generate employment in the host country either directly or indirectly:[112] directly, when a foreign affiliate hires local employees to work in its production facilities, and indirectly, when as a result of the establishment of a foreign affiliate, additional jobs are created in the economy.[113] This is the case, for example, when additional jobs are created in domestic firms which are suppliers, subcontractors, or service providers to the MNE.[114]

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[107] *World Investment Report 1999, supra* note 1 at 209.
[108] *Ibid.*
[109] *Ibid.* at 210.
[110] *UNCTAD Series, supra* note 13 at 50.
[111] *World Investment Report 1999, supra* note 1 at 221.
[112] *Ibid.* at 261.
[113] *Ibid.*
[114] *Ibid.*

Other jobs may also be created as a result of the increased spending by the MNE's employees.[115]

FDI, however, may also have a negative impact on the host country's employment.[116] FDI can lead to unemployment in the host country when the mode of entry of a foreign affiliate involves the acquisition of a local firm instead of greenfield investment (the creation of new production facilities). The reason for this is that a foreign firm upon acquiring a local firm may release some employees in order to reduce production costs.[117] In addition, FDI may also indirectly increase unemployment when local firms are forced to shut down or release employees in order to remain competitive with foreign firms.[118]

Therefore, the net impact of FDI on the host country's employment is difficult to ascertain. Whether FDI leads to greater or less employment in the host country will depend on a variety of factors such as the mode of entry selected by the MNE, the type of industry in which it takes place (labor intensive or capital intensive), the quality of the labor force, and the efficiency of the labor market and institutions.[119] In general, foreign affiliates tend to be more capital-intensive than local firms, but one also has to consider the counterfactual situation. In other words, in the absence of FDI would local investors been able to make a similar type of investment?[120] In general, FDI can add to the host country's employment when it is labor-intensive activities and it involves the establishment of new production facilities without the displacement of local firms.[121]

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[115] *Ibid.*
[116] *Ibid.*
[117] *Ibid.*
[118] *Ibid.*
[119] *Ibid.* at 262-264.
[120] *UNCTAD Series, supra* note 13 at 41.
[121] *World Investment Report 1999, supra* note 1 at 277.

4. Export Growth and Market Access

As was previously mentioned,[122] technology is a crucial element in determining a firm's success in today's highly competitive marketplace. Manufactured exports continue to expand more rapidly than primary commodities, and within the former, the sector that continues to grow the fastest are complex (high and medium technology products) manufactured products.[123] Export success not only calls for the application of new technologies, but also for countries to move up to higher value-added activities.[124] Unless developing countries are able to enter these markets, they will probably witness a continuous drop in their share of global exports. It is not easy, however, for developing countries to enter these markets. They face difficulties not only in reaching world levels of productivity and quality, but also in effectively marketing their products.[125] MNEs can assist developing countries in entering these markets.[126]

The role of FDI in promoting developing countries' exports can be particularly significant in complex manufactured products.[127] In these activities MNEs, mainly those from developed countries, tend to have the necessary marketing and technological skills to succeed on international markets.[128] Attracting this type of investment, however, requires host countries to provide foreign investors with excellent infrastructure facilities, a skilled labor force, and generally policies which favor export-oriented activities.[129] Until now only a few developing countries have been able to meet these requirements, the majority of them being Asian countries: Singapore, Malaysia, Philippines, and

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[122] See in this regard *supra* note 93 and accompanying text.
[123] *World Investment Report 1999, supra* note 1 at 229.
[124] *Ibid.* at 231.
[125] *Ibid.*
[126] *Ibid.*
[127] *Ibid.* at 234.
[128] *Ibid.*

Thailand. More recently some Latin American countries have also managed to attract this type of investment, the best examples being Mexico and Costa Rica.[130] In the future, however, more developing countries will need to make an effort to attract FDI into complex manufacturing activities since these activities normally offer the host country a greater chance of receiving beneficial technological spillovers.[131]

Local firms can also use an MNE's extensive corporate system in order to expand their exports. This is the case, for example, when domestic firms begin by supplying inputs to a foreign affiliate, and eventually move on to supplying other affiliates within the MNE's system.[132] Domestic firms may also be able to expand their exports by using an MNE's marketing channels through the use of original equipment manufacturing arrangements (OEM).[133] Under these agreements, a firm agrees to manufacture a product according to the buyer's specifications; that buyer then has the right to sell that product under his own brand name.[134]

Following an FDI-assisted export strategy, however, may have several disadvantages. For one, foreign affiliates tend to source a greater number of their inputs abroad than local firms.[135] This may be simply the result of the foreign affiliate's operation (the foreign affiliate may be established to act as an assembly plant), or it may be that the necessary inputs are not available in the local market.[136] Another

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[129] *Ibid.* at 238.
[130] *Ibid.* at 237- 238. In 1996, Intel decided to build a $300 million assembly and test plant in Costa Rica. Among the main factors that affected Intel's decision to do so were low-cost, yet highly qualified workforce, and a favorable business environment. See: *World Investment Report 1999, supra* note 1 at 184.
[131] *Ibid.* at 231.
[132] Moran, *supra* note 67 at 76-78.
[133] *World Investment Report 1999, supra* note 1 at 240.
[134] *Ibid.* at 241.
[135] *Ibid.*
[136] *Ibid.*

disadvantage of relying on FDI to boost exports is that a foreign affiliate's export decisions are ultimately made by its parent company.[137] Therefore, a parent company may decide to limit exports into certain markets in order to avoid competition between affiliates, or it may decide to center its production in one location, thereby reducing production in others.[138] Finally, there is the danger that a MNE may choose to relocate its production facilities to a cheaper production site when local skills and wages rise, instead of making further investments to upgrade existent facilities.[139]

B. Costs of FDI

1. The Displacement of Local Entrepreneurs

One of the greatest fears of host countries is that the entry of foreign investors will result in the displacement of local firms. This displacement, or what is sometimes referred to as the 'crowding out' effect of FDI, can occur either on financial markets or on product markets.[140] Crowding out on financial markets takes place when as a result of domestic borrowing by foreign affiliates, less funds are available for local firms.[141] There are basically two reasons for this: 1) the large quantities borrowed by foreign firms drive up interest rates thus making more difficult for local firms to borrow; and 2) local banks may prefer, for both risk and profitability reasons, to lend to foreign firms rather than to domestic ones.[142] Crowding out on the product market takes place when competition from foreign firms drives local firms out of the market.[143] This displacement

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[137] *Ibid.* at 242.
[138] *Ibid.*
[139] *Ibid.* at 247.
[140] *Ibid.* at 171.
[141] *UNCTAD Series, supra* note 13 at 38.
[142] *Ibid.*
[143] *World Investment Report 1999, supra* note 1 at 171.

may take place at the stage of the investment decision, as local investors abandon an investment decision when faced with the prospects of facing more efficient foreign competitors.[144] It may also take place during the operating stage of an enterprise as local firms are acquired by foreign investors or are forced out of the market by foreign firms.[145] The crowding out of domestic enterprises is particularly detrimental to the host country if those domestic firms could have reached international levels of competitiveness given an adequate protection.[146] This argument, called the 'infant industry' argument, was used by several Asian countries (i.e. Japan, Korea, and Taiwan) in order to build strong domestic firms.[147] Few countries, however, have been able to replicate the delicate balance between government intervention and free-market policies necessary for this strategy to succeed.[148]

2. Balance-of-Payments Deficit

Another important concern for host countries is the impact FDI will have on their balance-of-payments accounts. Although FDI may initially improve a country's balance-of-payments account as a result of the establishment of a foreign affiliate, this initial inflow of capital has to be weighed against the constant repatriation of profits by an affiliate to its parent firm.[149] FDI may also have a negative impact on the host country's balance-of-payments due to the importation of inputs by foreign firms.[150] As was previously mentioned, foreign affiliates have a greater tendency than domestic firms to

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[144] *Ibid.*
[145] *Ibid* at 320.
[146] *Ibid.*
[147] *Ibid.* at 209.
[148] *Ibid.* at 220.
[149] Hill, *supra* note 45 at 210
[150] *Ibid.* at 211.

source their inputs from abroad due to their familiarity with foreign suppliers or due to the low quality of domestic inputs.[151]

Another problem which is closely linked to the host country's balance-of-payments concerns is transfer pricing. Transfer pricing occurs due to the large amount of internal transactions that take place between a parent firm and its foreign affiliates.[152] These transactions cover everything from intra-company trade, payments on interest on intra-company loans, payments for services by personnel supplied by the parent company, and payments for technology.[153] In many of these transactions, it is difficult to establish market prices for the services or the technology provided by a parent firm to its foreign affiliate.[154] Therefore, MNEs may be able to manipulate these prices in order to transfer profits away from the host country, thereby lowering the benefits for the host economy.[155]

3. Loss of Sovereignty and Autonomy

Another concern for developing countries is the loss of economic sovereignty FDI may entail.[156] This fear is specially magnified when key sectors of the economic activity of the host country come under the control of foreign investors.[157] The concern for the host country is that key decisions affecting the country's economic future will be made by MNEs located in developed countries which have no concern for the country's well-

[151] See in this regard *supra* note 135 and accompanying text.
[152] *World Investment Report 1999, supra* note 1 at 166.
[153] *Ibid.*
[154] *Ibid.*
[155] *UNCTAD Series, supra* note 13 at 27.
[156] Hill, *supra* note 45 at 211.
[157] Mayobre, *supra* note 27 at 21.

being.[158] Host countries are also concerned that MNEs will be able to use their economic power to sway key political decisions in their favor.[159]

[158] *Ibid.*

[159] Sornarajah, *supra* note 63 at 51.

III. The Evolution of Venezuela's FDI Laws

A. 1914-1974

Significant quantities of foreign investment only began to enter Venezuela at the beginning of the past century as the result of oil exploration.[160] By 1914, a subsidiary of Royal Dutch Shell was already extracting small quantities of oil around Lake Maracaibo in the western region of Venezuela.[161] Major commercial oil production, however, would be delayed until after World War I, when in 1922, Royal Dutch Shell discovered a major oil field in the eastern section of Lake Maracaibo.[162] One of the wells in this field produced an astounding 900,000 barrels of oil in its first week of production.[163] This discovery indicated that Venezuela could become a major oil producer and foreign oil companies quickly rushed in to take advantage of the opportunity.[164] The country suddenly went from being an insignificant recipient of FDI to occupying one of the top spots in Latin America.[165]

Initial oil concessions were rather generous, as the government was interested in increasing oil production in order to increase its revenues.[166] The 1922 Petroleum Law established rather flexible terms for oil concessions. Concessions would be awarded for a period of forty years and government royalties would range between 8% and 15% of the oil's market value.[167] The strategy produced great dividends: from 1921 to 1929, the

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[160] Mayobre, *supra* note 27 at 61.
[161] D. Yergin, *The Prize* (New York and London: Touchstone, 1992) at 234.
[162] *Ibid.* at 235.
[163] Radway & Hoet-Linares, *supra* note 31 at 4.
[164] Yergin, *supra* note 161 at 236.
[165] Mayobre, *supra* note 27 at 31.
[166] Radway & Hoet-Linares, *supra* note 31 at 4.
[167] P.E. Sigmund, *Multinationals in Latin America* (Madison: University of Wisconsin Press, 1980) at 228.

country's oil production jumped from 1.4 million barrels to 137 million barrels.[168] That same year, oil revenues provided 76% of Venezuela's export revenues and half of the government's revenues.[169] Gradually, however, the country's policies towards foreign investment in the oil industry would become more restrictive. In 1943, a new hydrocarbons law established the extinction of all oil concessions after a period of forty years and increased government royalties up to 17%.[170] In 1948, the government's share of oil revenues was once again increased, this time to 50%.[171] For the next years, under the dictatorship of Marcos Pérez Jiménez, conditions on oil concessions would basically remain unchanged.[172] This would all end, however, when his government was overthrown in 1958, and a new democratic government came into power.[173] One of the first steps taken by this government was to decree another increase in oil taxes. With this increase, the country's share of oil revenues grew to 65%.[174] The government also decided to take a more active role in the country's oil industry and in 1960, it created a state oil company, the Corporación Venezolana de Petróleos (CVP- Venezuelan Petroleum Corporation).[175] That same year, with the hope of stabilizing oil prices, Venezuela also participated in the creation of an international oil cartel, the Organization of Petroleum Exporting Countries (OPEC).[176]

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[168] Yergin, *supra* note 161 at 236.
[169] *Ibid.*
[170] Radway & Hoet-Linares, *supra* note 31 at 5.
[171] *Ibid.*
[172] It is said that during this period of time, Marcos Pérez Jiménez, amassed a great personal fortune from oil revenues. In 1956-57, he also opened another round of forty-year concessions. *Sigmund, supra* note 167 at 230.
[173] *Ibid.* at 231.
[174] *Ibid.*
[175] *Ibid.*
[176] *Ibid.*

Foreign investment in the rest of Venezuela's economy paled in comparison to that in the oil industry. In the early 1960, however, there was an increase in FDI into the manufacturing sector as a result of the import substitution policy applied by the government.[177] Between 1962 and 1967, FDI inflows into the manufacturing sector more than doubled going from $176.71 million to $436.2 million.[178] The share of manufactures in total FDI inflows jumped from 3% to 8%.[179] In 1967, however, the petroleum industry still accounted for approximately 82% of total FDI inflows into the country.[180] After the petroleum and manufacturing industries, the most attractive sectors to foreign investment were commerce with $280 million, mining with $197.8 million, and banking with $43.1 million.[181] With regards to the origin of foreign investment, the largest investor in Venezuela was the United States which had invested a total of $3.81 billion up to 1967, followed by the United Kingdom with $1.31 billion.[182]

During this period, there were generally few restrictions upon the entry of foreign investments.[183] The only other sectors of the Venezuelan economy, outside of the petroleum industry, in which restrictions existed to foreign investments were the mining, banking, and insurance industries. In the mining industry, foreign investors were allowed to operate only under concession agreements.[184] In the insurance and banking industries,

[177] E.O. Ramírez, *La Política Comercial de Venezuela* (Caracas: Banco Central de Venezuela, 1992) at 58.
[178] Mayobre, *supra* note 27 at 32.
[179] *Ibid.*
[180] *Ibid.*.
[181] *Ibid.* FDI figures for 1967.
[182] *Ibid.* at 33.
[183] *Ibid.* at 83.
[184] *Ley de Minas*, Gaceta Oficia No. 121, January 18, 1945.

the 1965 Insurance Law and the 1970 Bank Reform Law limited foreign ownership in these sectors to 49% and 20% respectively.[185]

B. 1974 – 1990

During the 1970s, Venezuela began to assert greater control over foreign investments. Two events particularly highlighted this change in attitude: 1) Venezuela's accession to ANCOM and the promulgation of Decision 24, and 2) the nationalization of the country's oil industry. FDI policies would remain restrictive until the 1980s, when the onset of the debt crisis forced a radical reappraisal of the country's policies.

1. Decision 24

On February 13, 1973, Venezuela joined the Andean Common Market (ANCOM or Andean Pact).[186] ANCOM was originally created in 1969 by Bolivia, Colombia. Ecuador, Chile and Peru as an offshoot of the larger Latin American Free Trade Association (LAFTA).[187] The objective of these countries in creating a smaller common market was to facilitate the economic development of the lesser developed members of the group, thereby allowing them to compete in the future on more even terms with LAFTA's larger members (Brazil, Mexico, and Argentina).[188] Chile withdrew from

[185] *Ley de Seguros y Reaseguros,* Gaceta Oficial Extra. No. 984, July 9, 1965; *Ley de Reforma Parcial de la Ley General de Bancos y otras Instituciones Crediticias,* Gaceta Oficial Extra. No. 1454, Dec 30, 1970.
[186] Radway, *supra* note 33 at 290.
[187] *Ibid.* See also: E.E. Bledel, "The Latin American Development Process and the New Legislative Trends" (1980) 10:2 Ga. .J. Int'l & Comp. L. 325 at 331. The Latin American Free Trade Association was established in June of 1961 through the ratification of the Montevideo Treaty. Its original members were Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela.
[188] Horton, *supra* note 64 at 40.

ANCOM in 1976, citing fundamental discrepancies with ANCOM's economic policies.[189]

From its inception one of ANCOM's main goals was to unify its Member Countries' economic policies.[190] Probably the most famous legislative act in this respect was Decision 24 (or Andean Foreign Investment Code) issued on December 31, 1970.[191] Through Decision 24, ANCOM authorities hoped to promote indigenous capital formation, to protect ANCOM from foreign domination, and to minimize any negative effects associated with foreign investment.[192] The main idea behind Decision 24 was to carefully guide foreign investment into those sectors in which it was needed most, without impeding it or encouraging its outward flow.[193]

Decision 24 became effective in Venezuela on January 1, 1974,[194] with complementary regulation Decrees 62[195] and 63[196] being issued in April of that year. Decision 24 introduced substantial changes to the country's FDI legislation. One of these changes was the requirement of previous screening for all foreign investments.[197] In Venezuela, the agency in charge of this function was the Superintendence of Foreign Investments (SIEX – Superintendencia de Inversiones Extranjeras).[198] Before approving

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[189] *Ibid.* at 46.
[190] *Ibid.* at 41.
[191] *Decision 24, supra* note 32.
[192] See: C.T. Oliver, "The Andean Foreign Investment Code: A New Phase in the Quest for Normative Order as to Direct Foreign Investment" (1972) 66 A.J.I.L. 763 at 768. See also: Radway & Hoet-Linares, *supra* note 31 at 14-15.
[193] Radway, *supra* note 33 at 291.
[194] Radway & Hoet-Linares, *supra* note 31 at 14.
[195] *Decree 62,* Gaceta Oficial Extra No.1650, April 29, 1974. *Translated in* (1974) 13 I.L.M. 1220 [hereinafter *Decree 62*].
[196] *Decree 63,* Gaceta Oficial Extra No. 1650, April 29, 1974. *Translated in* (1974) 13 I.L.M. 1221 [hereinafter *Decree 63*].
[197] *Decision 24, supra* note 32. Art. 2.
[198] *Decree 63, supra* note 196. Art 3. SIEX was in charge of screening all foreign investments governed by Decision 24 and Decrees 62 and 63. Foreign investments in the petroleum, mining, and tourism industries were excluded from these laws and therefore outside of SIEX's scope.

an investment, SIEX had to ensure that the investment complied with at least one of the following requirements:[199]

1) that the foreign investment incorporate or planned to incorporate at least 50% national value-added;
2) that local value-added be at least 30% if the investment was export-oriented;
3) that the investment generate a considerable number of employment;
4) that the investment locate in areas considered to be of general underdevelopment;
5) that the investment incorporate valuable technology;
6) that the investor agree to transform to a national or mixed enterprise in a shorter period of time than that established in Decision 24;
7) that the investor agree to reinvest some of its profits back into the country.

In addition to these restrictions, SIEX could not authorize foreign investments in those areas which were already adequately covered by existing enterprises, or investments whose purpose was to acquire national investors' shares, rights, or participations.[200]

Moreover, certain sectors of the economy were reserved for national enterprises (enterprises in which national investors had at least an 80% equity stake).[201] According to article 1 of Decree 62, the following sectors were reserved for national enterprises: 1)

[199] *Decree 63, supra* note 196. Art 27. Performance requirements are controls imposed by the host country upon the operation of foreign enterprises. See: *supra* note 45 at 215.
[200] *Decision 24, supra* 32. Art 3.
[201] Article 1 of Decision 24 defines a national enterprise as an: "enterprise organized in the recipient country, more than 80% of whose capital belongs to national investors, provided that in the opinion of the competent national authority, that proportion is reflected in the technical, financial, administrative, and commercial management of the enterprise." That same article also defines national investors. National investors are: "The State, national individuals, national non-profit entities, and the national enterprises defined in this article. Foreign nationals with consecutive residence in the recipient country of no less than one year, who renounce before the competent national authority the right to re-export the capital and to transfer profits abroad, shall also be considered to be national investors." See: *Decision 24, supra* note 32. Art 1.

public services (telephone, drinking water, and sewage, electricity services, and surveillance and security services), 2) television and radio broadcasting, 3) newspapers and magazines in the Spanish language, 4) internal transportation of persons and property, 5) publicity, 6) internal commercialization of goods and services, and 7) professional services and activities of consultation (i.e. legal,[202] accounting,[203] financial,[204] engineering and architecture,[205] and dental[206] services). Banking and insurance activities were also reserved to national enterprises.[207]

Once a foreign enterprise was granted entry into the country, it then had to comply with ANCOM's divestiture requirement.[208] This obligation required all foreign enterprises established in Member Countries after July 1, 1971 to transform into mixed or national enterprises.[209] In Venezuela, all those foreign enterprises constituted after January 1, 1974, had to comply with this obligation.[210] Similar to Colombia and Peru, foreign enterprises in Venezuela were given a period of fifteen years to comply with this obligation. In the case of ANCOM's lesser-developed countries (Bolivia and Ecuador), foreign enterprises had twenty years.[211] This transformation was to take place gradually,

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[202] *Ley de Abogados,* Gaceta Oficial No. 1.081, January 23, 1967.
[203] *Ley de Ejercicio de la Contaduría Publica,* Gaceta Oficial No. 30.273, December 5, 1973.
[204] *Ley de Ejercicio de la Profesión de Economista,* Gaceta Oficial No. 29687, December 15, 1971.
[205] *Ley de Ejercicio de la Ingeniería, la Arquitectura y Profesiones Afines,* Gaceta Oficial No. 22.822, November 26, 1958.
[206] *Ley de Ejercicio de la Odontología,* Gaceta Oficial No. 29.288, August 10, 1970.
[207] *Decision 24, supra* note 32. Art 42. See: *supra* note 185 and *Decreto Ley 870 (concerning insurance and reinsurance companies)* Gaceta Oficial Extra No. 1743, May 22, 1975.
[208] *Decision 24, supra* note 32. Art 30
[209] *Ibid.* According to article 1 of Decision 24 a mixed enterprise was: "and enterprise organized in the recipient country and whose capital belongs to national investors in a proportion which may fluctuate between 51 and 80%, provided that in the opinion of the appropriate national authority, that proportion is reflected in the technical, financial, administrative, and commercial management of the enterprise." In that same article a foreign enterprise is defined as "an enterprise whose capital in the hands of national investors amounts to less than 51% or, if that percentage is higher, it is not reflected, in the opinion of the proper national authority, in the technical, financial, administrative, and commercial management of the enterprise" For a definition of a national enterprise see: *supra* note 201.
[210] *Decree 63, supra* note 196. Art 51.
[211] *Decision 24, supra* note 32. Art 30.

with local investors steadily acquiring larger equity stakes. At the beginning of production, national investors were required to have at least a 15% equity stake, this share would increase to 30% upon completion of one-third of the transformation period, and after two-thirds of the transformation period, this share was supposed to be 45%.[212]

Not all foreign enterprises were required to comply with this obligation. Those foreign enterprises established prior to the date of Decision 24's entry into force were exempted from this obligation.[213] In Venezuela this meant that foreign enterprises established prior to January 1, 1974, were exempted from this obligation.[214] These enterprises, however, would not enjoy ANCOM's duty free benefits.[215] In addition, foreign enterprises which exported more than 80% of their goods outside of ANCOM countries,[216] and foreign enterprises in tourist activities were also exempted from this rule.[217]

Decision 24 also limited profit repatriations by foreign investors. Originally, foreign investors were permitted to repatriate profits only up to an amount equal to 14% of their annual investment.[218] This amount was later raised to 20% by Decision 103.[219] Foreign investors whose profits exceeded these limits had two choices: 1) they could reinvest those profits back into the enterprise, in which case government authorization would be necessary when those profits exceeded 5% of annual profits[220] (Decision 103

[212] *Ibid.*
[213] *Decision 24, supra* note 32. Art 30.
[214] *Decree 63, supra* note 196. Art 51.
[215] *Ibid.* Art 52.
[216] *Decision 24, supra* note 32. Art 34.
[217] *Decree 63, supra* note196. Art 1.
[218] *Decision 24, supra* note 32. Art 37.
[219] *Ley Aprobatoria de la Decisión 103 de la Comisión del Acuerdo de Cartagena que Reforma el Régimen Común de Tratamiento a los Capitales Extranjeros y sobre Marcas, Patentes, Licencias y Regalías,* Gaceta Oficial Extra No. 2052, June 20, 1977. Art 37 [hereinafter *Decision 103*].
[220] *Decision 24, supra* note 32. Art 13.

raised this limit up to 7%)[221], or a foreign investor could invest those profits in government-approved securities or what were known as Portfolio Development Securities.[222]

To avoid the "hidden" repatriation of profits, Decision 24 established strict controls over foreign credits.[223] All foreign credits had to be previously approved by the competent national authority of each Member Country.[224] For credits between a foreign affiliate and its parent company, annual interest rates could not exceed by more than three points the rate of interest of first class securities in the financial market of the currency in which the loan was made.[225] In addition, access to local credit by foreign firms was limited to short-term loans.[226]

In order to extract the maximum benefits from foreign technology, Decision 24 also instituted strict regulation over technology transfer agreements. ANCOM drafters believed that in the past these contracts had been used by foreign investors to repatriate large profits without transferring much technology to the host country.[227] In order to remedy this situation, Decision 24 required previous screening of all technology transfer agreements.[228] In addition, Member Countries could not approve technology transfer

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[221] *Decision 103, supra* note 219. Art 5.
[222] *Decree 63, supra* note196. Art 66.
[223] J.J. Jova, C.E. Smith & T.F. Crigler, "Private Investment in Latin America: Renegotiating the Bargain" (1984) 19 Texas Int'l L. J. 3 at 19.
[224] *Decision 24, supra* note 32. Art 14.
[225] *Ibid.* Art 16.
[226] *Ibid.* Art 17.
[227] M.B. Baker & M.D. Holmes, "An Analysis of Latin American Foreign Investment Law: Proposals for Striking a Balance Between Foreign Investment and Political Stability" (1991) 23 U. Miami Inter-Am. L. Rev. 1 at 17.
[228] *Decision 24, supra* note 32. Art 18. Art 55 of Decree 63 states: "[t]he documents which contains the acts, contracts or agreements of any nature which will have effect in the national territory, regardless of whether they provide for payments or compensation, must be registered as provided in the preceding Article when they provide for: "

1) The grant of the use or authorization for the exploitation of trademarks.

contracts when they contained restrictive clauses that limited the value of the technology.[229] Furthermore, technological contributions would only give a foreign investor the right to royalty payments, but in no case would they be considered capital contributions.[230] Finally, royalty payments between a foreign subsidiary and its parent company were prohibited.[231]

As a final note, Decision 24 prohibited the use of international arbitration for the settlement of investment disputes and the subrogation of sovereign states to foreign investor's rights.[232] This is no doubt a reflection of the Calvo Doctrine that was popular in many Latin American states at the time.[233]

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2) The grant of the use or authorization for the exploitation of inventions, improvements, models and industrial designs.
3) The furnishing of technical know-how by means of plans, diagrams, instructive models, instructions, formulas, specifications, training of personnel and by means of other means.
4) Furnishing of basic or detailed engineering for the execution of installations for the manufacture of products.
5) Technical assistance, in any form in which it may be furnished.
6) Administrative and management services."

[229]Among those restrictive clauses prohibited by Art 20 of Decision 24 were: "
(a) Clauses by virtue of which the furnishing of technology imposes the obligation for the recipient or enterprise to acquire from a specific source capital goods, intermediate products, raw material, and other technologies or of permanently employing personnel indicated by the enterprise which supplies the technology. In exceptional cases, the recipient country may accept clauses of this nature for the acquisition of capital goods, intermediate products or raw materials, provided that their price corresponds to current levels in the international market;
(b) Clauses pursuant to which the enterprise selling the technology reserves the right to fix the sale or resale prices of the products manufactured on the basis of the technology;
(c) Clauses that contain restrictions regarding the volume and structure of production;
(d) Clauses that prohibit the use of competitive technologies;
(e) Clauses that establish a full or partial purchase option in favor of the supplier of the technology;
(f) Clauses that obligate the purchaser of technology to transfer to the supplier the inventions or improvements that may be obtained through the use of technology;
(g) Clauses that require payment of royalties to the owners of patents for patents which are not used; and
(h) Other clauses with equivalent effects."

[230]*Decision 24, supra* note 32. Art 21

[231] *Ibid.* Art 21.

[232] *Ibid.* art 51.

[233] Jova, Smith & Crigler, *supra* note 223 at 12. The Calvo Doctrine was formulated by Argentine jurist Carlos Calvo in 1868 as a response to continual interference by home countries in Latin American affairs. The two main tenets of this doctrine are: 1) strict nonintervention by foreign powers in the internal affairs of the host country; and 2) absolute subjection of foreigners to the laws and jurisdiction of the host country.

2. The Nationalization of Venezuela's Oil Industry

Upon taking office on March 12, 1974, Venezuelan President Carlos Andrés Pérez announced his intention to nationalize the country's oil industry.[234] For observers of the Venezuelan oil industry, the move came as little surprise due to the steady increase in government participation that had taken place over the years. Despite the steady increase in government participation in this sector, the government had remained reluctant to nationalize the oil industry. In the 1970s, however, a variety of events finally pushed the government to make this final decision.

For years government officials felt that foreign companies were not doing sufficient to expand oil production in Venezuela. In 1971, the government issued a Hydrocarbons Reversion Law[235] which was supposed to lay out the terms under which foreign companies would operate until the expiration of oil concessions in 1983. In addition, this law allowed government to control production levels in order to ensure that foreign oil companies did not drastically cut back on their production before the reversal date.[236] Despite these controls, however, oil production levels continued to decline.[237] Growing difficulties in negotiating production levels began to convince many government officials that the government should nationalize the industry before the expiration of concession agreements.[238] The oil shock in 1973 due to the Arab embargo against the United States further fueled the nationalization debate.[239] Venezuela, which did not participate in the embargo, greatly benefited from the increase in oil prices. The

[234] Sigmund, *supra* note 167 at 237.
[235] *Ley sobre Bienes Afectos a Reversión en las Concesiones de Hidrocarburos,* Gaceta Oficial No. 29.577, August 6, 1971.
[236] Sigmund, *supra* note 167 at 234.
[237] *Ibid.* at 235.
[238] *Ibid.*
[239] *Ibid.* at 236.

country's income per barrel of oil jumped from $3.10 in January 1973 to $14.08 per barrel in December of that same year.[240] From 1972 to 1974, oil revenues nearly quadrupled, going from $2 billion in 1972 to $9.7 billion in 1974.[241] The additional income gave the government a comfortable cushion against a possible drop in income caused by the nationalization of the oil industry.[242] Finally, in 1974, the country's effort to nationalize its oil industry received important international support with the promulgation of two important United Nations resolutions: the Declaration on the Establishment of a New International Economic Order adopted on May 1, 1974,[243] and the Charter of Economic Rights and Duties of States, adopted on December 12, 1974.[244] These two instruments asserted developing countries' right to ownership over their natural resources.[245]

As a prelude to the nationalization of its oil industry, Venezuela nationalized its steel industry. Since 1950, two major U.S. corporations (U.S. Steel and Bethlehem Steel) had been extracting iron ore from two large mines located in the Guyana Highlands.[246] Negotiations with these companies began in June of 1974, and by November of that year the government issued a decree extinguishing iron ore concessions

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[240] *Ibid.*
[241] *Ibid.*
[242] *Ibid.*
[243] "Declaration on the Establishment of a New International Economic Order", United Nations General Assembly Resolution 3201 (S-VI) (1974) in UNCTAD, *International Investment Instruments: A Compendium,* Volume 1: Multilateral Instruments (New York and Geneva: UNCTAD, 1996) at 47 (UNCTAD/DTCI/30. Vol. I, Sales No. E.96.II.A.9).
[244] "Charter of Economic Rights and Duties of States", United Nations General Assembly 3281 (XXIX) (1974) in UNCTAD, *International Investment Instruments: A Compendium,* Volume 1: Multilateral Instruments (New York and Geneva: UNCTAD,1996) at 52 (UNCTAD/DTI/30. Vol I, Sales No. E.96.II.A.9). See also: Radway & Hoet-Linares, *supra* note 31 at 13.
[245] See: E.E. Murphy, Jr, "Decision 24, Mexicanization, and the New International Economic Order: The Anatomy of Disincentive" (1978) 13 Texas Int'l L. J. 289 at 298 –302.
[246] Radway & Hoet-Linares, *supra* note 31 at 6. See also: Sigmund, *supra* note 167 at 238.

effective as of January 1, 1975.[247] As compensation, U.S. Steel received approximately $84 million and Bethlehem Steel $17 million.[248] Setting an important precedent for the oil industry, as part of their compensation both companies also signed technical assistance and management service contracts with the government.[249] Finally, both companies also entered into iron ore supply contracts, Bethlehem Steel agreed to purchase 9.9 metric tons of iron ore over a period of three years, while U.S. Steel agreed to purchase 77 million metric tons over a period of seven years.[250]

Shortly after the nationalization of the iron ore industry, in March of 1975, the government introduced the Petroleum Industry Nationalization Law[251] before Congress.[252] From its inception, most of the discussion centered on article 5 of the draft bill, which would still allow the state-owned oil company, following Congressional approval, to enter into joint venture agreements with private entities after the nationalization of the petroleum industry.[253] Opposition members charged that this article would leave a back-door open for the return of foreign companies into the petroleum industry.[254] Finally, after much discussion, a government-controlled Congress

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[247] *Decreto que Reserva la Explotación del Mineral de Hierro al Estado,* Gaceta Oficial No. 30.577, December 16, 1974.
[248] Sigmund, *supra* note 167 at 238.
[249] *Ibid.*
[250] *Ibid.* at 239.
[251] *Ley Orgánica que Reserva al Estado la Industria y el Comercio de los Hidrocarburos,* Gaceta Oficial Extra No. 1769, August 29, 1975. [hereinafter *Nationalization Law*]
[252] *Ibid.* at 241.
[253] *Nationalization Law, supra* note 251. Article 5 of the law reads [*own translation*]: "The State will realize the activities indicated in article 1 of this law either directly or through any of its entities; nonetheless, in order to provide a better service, the State may enter into operating agreements without affecting the public nature of the activity.
In special cases and when public interests so dictate, the government or any of the previously mentioned entities may enter into joint ventures with private entities in order to realize any of the reserved activities. These joint ventures will be for a limited period of time only and government will retain control over the project. These joint ventures may not be signed without prior Congressional approval. Congress, taking into consideration the recommendations made by the National Executive, will establish the terms for these agreements."
[254] Sigmund, *supra* note 167 at 241.

managed to pass the bill without little modifications on August 29, 1975.[255] Once the bill became effective on January 1, 1976, it signaled the end of foreign participation in Venezuela's oil industry.

Regarding the question of compensation, foreign companies were initially reluctant to accept the government's offer of $1.1 billion which was calculated according to net book value of their investment.[256] Company officials argued that this compensation was only about 20 percent of the actual value of their investment and only 10 percent of its replacement value.[257] Foreign companies, however, had little choice but to accept the government's offer since its was based on their own book estimates, and the companies also hoped to gain indirect compensation by signing technical assistance agreements and supply contracts with the government.[258] Finally, in October of 1975, the government reached an agreement with foreign oil companies. This agreement called for the government to pay slightly over $1 billion dollars in compensation.[259] In addition to this compensation, foreign oil companies entered into technical assistance and supply contracts with the government. The technical assistance agreements called for foreign oil companies to provide the state-owned oil company (Petroven, now known as PDVSA) with assistance for a period of four years through the loan of technicians, training, technology, computer programs, and the establishment of research facilities.[260] In return for this assistance, the government agreed to pay foreign companies a remuneration based

[255] *Nationalization Law, supra* note 253.
[256] Sigmund, *supra* note 167 at 242.
[257] *Ibid.*
[258] *Ibid.* at 243.
[259] The exact amount of the compensation was $1,012,571,901.67. This quantity was divided in the following manner: Exxon received $512 million, $73 million in cash and the remainder in bonds to be paid out over five years with 6 percent interest rates; Shell would receive $250 million, $10 million in cash and the rest in bonds. *Ibid.*
[260] *Ibid.* at 245.

on the price of each barrel of oil.[261] According to some estimates, this remuneration amounted to approximately $100 million a year.[262] Under the supply contracts, foreign oil companies agreed to purchase the majority of the country's oil production, approximately 1.75 million barrels out of the 2.4 million barrels of daily production in 1976.[263] These contracts were signed for a period of two years, with foreign oil companies having the right to renegotiate prices every three months.[264]

3. The Debt Crisis

In 1973, as a result of the large quantity of funds at its disposal due to high oil prices, and the evident deterioration in the import-substitution model practiced by the government since the 1960s,[265] the government decided to accentuate its role in the Venezuelan economy.[266] In addition to its large oil revenues, the government decided to finance its expenditures by borrowing large sums on international financial markets. The large quantity of funds available at the time along with low interest rates made bank loans a very attractive source of capital.[267] Through large public expenditure, the government hoped to give the country a solid industrial base and to make it an important player in the global economy.[268]

The initial results of this strategy were quite impressive. From 1973 to 1978, GNP grew at an average between 6 and 7%, hitting its highest mark in 1976 when it

[261] *Ibid.* According to government sources, the remuneration foreign oil companies received under the technical assistance agreements was 13.4 cents per barrel.
[262] *Ibid.*
[263] *Ibid.*
[264] *Ibid.*
[265] Ramirez, *supra* note 177 and accompanying text.
[266] *Ibid.* at 60.
[267] *Ibid.* at 61.
[268] *Ibid.* at 62.

reached 8.4%.[269] During this time, a number of important investments were made in the iron, aluminum, petrochemical, and petroleum industries. In addition, there was the construction of a number of important infrastructure projects such as the Caracas subway system.[270] Investment during this time grew at an outstanding pace, with public investment accounting for most of that growth. From 1973 to 1977, public investment grew at an annual rate of 22.4%.[271]

In 1978, however, the economy began to cool off. The country was beginning to show its first signs of what was an 'overdose' of investment. A large quantity of the government's expenditure had gone into largely inefficient, bloated, state-enterprises.[272] Furthermore, the country's balance-of-payments situation began to suffer as a result of lower oil prices on international markets.[273] The country's current account deficit, moreover, could not be financed through its capital account due to the reluctance of foreign banks to continue lending to heavily indebted countries like Venezuela.[274] In addition, the country's capital accounts also suffered due to the large debt payments.[275] The situation deteriorated to such a point that finally on February 18, 1983, the government decided to apply foreign exchange controls.[276] It is estimated that in the eighteen months prior to the establishment of foreign exchange controls, approximately $10 billion had fled the country.[277]

[269] *Ibid.* at 63.
[270] *Ibid.* at 62.
[271] *Ibid.* at 62
[272] A. Francés, *Venezuela posible siglo XXI* (Caracas: Ediciones IESA, 1999) at 69-72.
[273] Ramirez, *supra* note 177 at 64.
[274] *Ibid.* at 62.
[275] *Ibid.* at 66.
[276] *Ibid.* at 65.
[277] *Ibid.*

The debt crisis produced a radical reappraisal of the country's economic strategy. Low commodity prices and the refusal of international banks to lend to highly indebted countries meant that there were less available sources of capital.[278] Under these circumstances, FDI once again became an attractive source of capital.[279] Attracting foreign capital, however, would not be very easy. As a result of the debt crisis, many foreign investors were wary of investing in the region due to the constant risk that host countries would restrict the repatriation of profits.[280] In addition, the harsh restrictions placed upon foreign investment had clearly discouraged foreign investors from investing in the region.[281] The response of Venezuela and other Latin American countries to this drop in foreign investment was to liberalize their foreign investment laws.[282]

Initial attempts to liberalize foreign investment regulation were rather tentative. On July 16, 1986, Venezuela issued Decree 1200.[283] This Decree, however, introduced two important modifications in the country's FDI regime. A first was the simplification of the approval procedures by granting immediate approval to all foreign investments which met any of the requirements established by the law.[284] The other important

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278 I.F.I. Shihata, "Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme" (1987) 21:3 Int'l Lawyer 671 at 674. According to estimates of the Economic Commission for Latin America (ECLA, now known as the Economic Commission for Latin America and the Caribbean, ECLAC), Venezuela's foreign debt in 1983 reached $16.4 billion. See: *supra* note 177 at 63.

279 *Ibid.*

280 *Ibid.*

281 Baker & Holmes, *supra* note 227 at 20.

282 K. Garcia & F. Delgado, *La Inversión Extranjera y Subregional y los Contratos sobre Tecnología en el Acuerdo de Cartagena* (Caracas: Diaz-Llanos, 1990) at 17.

283 *Decree 1200,* Gaceta Oficial Extra No. 3881, August 29, 1986.

284 *Ibid.* art 19. These requirements were similar to those found in art 27 of Decree 63 namely:

1) to incorporate at least 40% of national added value in their products;
2) that the industry is basically export oriented and incorporates in their products at least 30% national added value;
3) that it generated significant volumes of employment;
4) that it locate in areas of the country considered to be of relatively underdevelopment;
5) that it incorporate valuable technology;
6) that the enterprise be committed to investing at least 50% of their profits in the country;

modification found in Decree 1200 was the elimination of mandatory divestiture for foreign enterprises. Foreign enterprises would only have to comply with divestiture requirements under two circumstances: 1) when they operated in those sectors reserved for national (80% national capital) or mixed enterprises (51-80% national capital),[285] or when they wished to benefit from ANCOM's duty-free benefits.[286]

The following year, on May 11, 1987, the Andean Commission issued Decision 220.[287] This Decision, which replaced Decision 24, incorporated some of the changes that had already been taken place in ANCOM countries.[288] Decision 220 gave Member Countries greater liberties in screening foreign investments. Article 4 of the Decision allowed Member Countries to authorize foreign investments whose purpose was to

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7) that the investment contribute significantly to import-substitution strategies; and
8) any other conditions established by the National Executive.

[285] *Ibid*. Arts 21 and 22 of Decree 1200 establish those sectors reserved for national and mixed enterprises. Art 21 [*own translation*]: "The following sectors of the economic activity are reserved to national enterprises such as defined in Decision 24:

a) Public services: telephone, telecommunications, water and drainage; the generation, transmission, distribution, and sale of electricity; sanitary services, and security and surveillance services.
b) Television and radio; newspapers and magazines in the Spanish language; the internal transportation of people and goods; and publicity. Excluded from this provision are scientific, technological, or cultural publications in the Spanish language.
c) Professional consulting services, advice, design and analysis of projects and the performance of general studies in those areas which require professional services regulated by domestic laws, with the exception of those industries which in SIEX's judgment contribute valuable technology to the country. In this last case, foreign participation may not exceed 49%.

Art 22: The following sectors of the economic activity are reserved to mixed enterprises as defined in Decision 24:

a) Internal retail activities. Foreign enterprises established in the country prior to February 8, 1977 can participate directly in the sale of those directly or through enterprises controlled through their capital or management by the foreign enterprise, as long the goods are produced in the country by the enterprise.
b) The administration of concessions granted in accordance to the respective law.
c) Basic industries as defined by the National Executive.
d) Export services; garbage and waste collection; the transport and deliver of valuables, correspondence or documents.

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[286] *Ibid.* Art 49.

[287] *Ley Aprobatoria de la Decisión 220 de la Comisión del Acuerdo de Cartagena, sobre la Sustitución de las Decisiones 24 y Conexas, sobre el Régimen Común de Tratamiento a los Capitales Extranjeros y sobre Marcas, Patentes, Licencias y Regalías,* Gaceta Oficial No. 34.014, July 25, 1988. *Translated in* (1998) 27 I.L.M. 978. [hereinafter *Decision 220*]

[288] See: Garcia & Delgado, *supra* note 282 at 20.

acquire a national investor's shares or ownership rights. Another important modification found in Decision 220 was that it eliminated mandatory divestiture for all foreign enterprises, restricting this obligation only to those foreign enterprises who wished to enjoy ANCOM's duty-free benefits.[289] Regarding technology transfer agreements, Decision 220 allowed Member Countries to authorize royalty payments between foreign affiliates and their parent companies.[290] Finally, host countries were also authorized to use arbitration in the settlement of investment disputes.[291]

C. 1990 – Present

The 1990s have marked a radical departure from the highly restrictive FDI policies pursued in Venezuela during the 1970s and the 1980s. During the 1990s the main characteristics of Venezuela's FDI regime were the removal of the majority of investment barriers and a strengthening in the standards of treatment for foreign investments. During this period there were four events of particular relevance: 1) the promulgation of Decision 291, 2) foreign participation in the country's oil industry, 3) the signing of bilateral investment treaties, and 4) the creation of multilateral investment rules within the World Trade Organization (WTO).

1. Decision 291

In 1989, Carlos Andrés Pérez entered his second term in office. In contrast to his first term in office, President Pérez now inherited a heavily indebted country in the midst

[289] *Decision 220, supra* note 287. Art 27.
[290] *Ibid.* Art 21.
[291] *Ibid.* Art 34.

of severe economic difficulties.[292] In order to reverse this situation, President Pérez decided to abandon the import-substitution model of development and institute a more market-oriented economy.[293] Among the major steps taken were: 1) the abolition of foreign exchange controls; 2) devaluation of the exchange rate; 3) tough anti-inflation measures; and 4) greater openness towards international trade and investment.[294]

As part of this greater openness towards foreign investment, on January 18, 1990, the government issued Decree 727[295] which eliminated the majority of restrictions upon foreign investment. It simplified authorization procedures, leaving foreign investors with the sole obligation of registering their investment with SIEX.[296] It addition, it granted foreign investors access to most sectors of the Venezuelan economy. The only sectors which were left reserved to national enterprises were security and surveillance services, television and radio, newspapers in the Spanish language, and professional services.[297] It even allowed foreign investors to enter into joint ventures in basic products sector (primary activities of exploration and exploitation of minerals).[298] Furthermore, it eliminated restrictions upon the repatriation of profits,[299] and it granted foreign companies access to local credit, including the possibility of raising funds through the local stock market.[300] Finally, Decree 727 also eliminated previous authorization for all technology transfer agreements.[301]

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[292] Ramirez, *supra* note 177 at 70.
[293] Jatar, *supra* note 24 at 2.
[294] Ramirez, *supra* note 177 at 70-72.
[295] *Decree 727*, Gaceta Oficial No. 34.397, January 26, 1990.
[296] *Ibid.* Art 19 [*own translation*]: "All foreign investments made in national, mixed, or foreign enterprises are authorized as long as they do not infringe national laws.
All foreign investments must be registered with the Superintendence of Foreign Investments..."
[297] *Ibid.* Art 23.
[298] *Ibid.* Art 24.
[299] *Ibid.* Art 35.
[300] *Ibid.* Art 57 [*own translation*]: "Foreign and mixed enterprises will have access to internal credit without any other limitations than those established by the law. In addition, they may issue ordinary or preferential

Shortly after the promulgation of Decree 727, there were also important legislative changes at the regional level. Following their meeting in La Paz, Bolivia, in November of 1990, the Presidents of the different ANCOM countries decided to further remove all obstacles to the flow of foreign investment. In response to this call on March 21, 1990, the Andean Commission issued Decision 291.[302]

Decision 291 grants foreign investors equal treatment with national investors.[303] No longer is previous authorization required to invest in ANCOM countries, instead the only obligation foreign investors have upon entry is to register their investment with the competent national authority.[304] In addition, most of the restrictions upon the operation of foreign enterprises have also been eliminated. Decision 291 eliminates divestment requirements for foreign enterprises. [305] It also eliminates restrictions upon the repatriation of profits.[306] Finally, Decision 291 removes previous authorization for all technology transfer agreements, but still prohibits Member Countries from registering these contracts when they contain restrictive clauses.[307]

In order to make national legislation comply with that at the regional level, on February 13, 1992, Venezuela issued Decree 2095.[308] This Decree made relatively few changes to Decree 727. Among the most noticeable modifications were that it allowed

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shares, bonds or any other short-term or long-term debt instrument previous compliance with all the requirements established in the Law for the Public Offering of Securities. These instruments may also be negotiated on the stock market."

[301] *Ibid.* Art 62.

[302] *Ley Aprobatoria de la Decisión 291 sobre el Régimen Común de Tratamiento a los Capitales Extranjeros y sobre Marcas, Patentes, Licencias y Regalías,*, Gaceta Oficial Extra No. 4284, June 28, 1991.[hereinafter *Decision 291*]

[303] *Ibid.*. Art 2 [*own translation*]: "Foreign investors will have the same rights and obligations as national investors, save the exceptions found in each Member Countries' legislation."

[304] *Ibid.* Art 3.

[305] *Ibid.* Art 8.

[306] *Ibid.* Art 4.

[307] These clauses are nearly identical to those found in art 20 of Decision 24. See: *supra* note 229 and accompanying text. In Decision 291, these clauses are found in article 14.

technology to be considered as part of a foreign investor's capital contributions;[309] it eliminated prior authorization for all foreign credits;[310] and it established the possibility of using arbitration for the settlement of investment disputes.[311]

Most recently, Decree 2095 has been complemented by the Law to Promote and Protect Foreign Investments issued on October 3, 1999.[312] This new law significantly expands the protection offered to foreign investments in the country. First of all, the law not only protects investments made to acquire real estate or financial assets, it also protects foreign investors' intellectual property rights and rights acquired through concession agreements.[313] The new law also strengthens standards of treatment for foreign investments. Foreign investments are guaranteed fair and equitable treatment,[314] along with national[315] or most-favored-nation treatment,[316] whichever is the most

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[308] *Decree 2095,* Gaceta Oficial No. 34.930, March 25, 1992.

[309] *Ibid.* Art 1(d). Previous to Decree 2095, a foreign investor could only contribute tangible goods to a company's capital. This prohibition was still contained in article 71 of Decree 727: [own translation]: "Technological contributions made as a result of Articles 62 and 64 of this regulation will give the right to royalties, but cannot be considered as capital contributions by the owner or supplier of the technology to the firm." *Decree 727, supra* note 295.

[310] The previous Decree, Decree 727, required previous authorization for foreign credits. Decree 2095 makes no reference to this aspect. Therefore, there are no longer restrictions in this respect.

[311] *Ibid.* Art 25.

[312] *Decreto con Rango de Fuerza de Ley sobre Promoción y Protección de Inversiones,* Gaceta Oficial Extra No. 5390, October, 22, 1999. [*Law to Promote and Protect Investments*]

[313] *Ibid.* Art 3 (1) [own translation]: "Investment: Any asset destined towards the generation of an income, under any of the corporate or contractual forms permitted in Venezuelan legislation, including movable and immovable, material or immaterial goods, over which exists property rights; credit rights, rights to a performance having a financial value; intellectual property rights, including know-how, prestige and clientele; and those rights acquired through public law, including concessions for exploration, extraction, or exploitation of natural resources and the construction, exploitation, conservation and maintenance of national public works and for the prestation of a national public service, in addition to any other right conferred by law, o through administrative decision made in accordance to the law."

[314] *Ibid.* Art 6 [own translation]: "International investments will be guaranteed fair and equitable treatment, in accordance to the norms and criteria of international law and will not be subjected to any arbitrary or discriminatory measures which impede its maintenance, operation, use, enjoyment, expansion, sale or liquidation."

[315] *Ibid.* Art 7 [own translation]: "Investments and international investors will enjoy the same rights and obligations as national investments and investors, with the only exceptions being those established in special laws and the limitations found in this law"

[316] *Ibid.* Art 8 [own translation]: " There will no discrimination in the treatment of international investments or investors, due to the origin of their capital..."

favorable.[317] In addition, the law expressly prohibits the confiscation or expropriation of foreign property.[318] Expropriations may only be taken in a non-discriminatory manner, for a public purpose, in accordance with due process of law, and upon payment of prompt, adequate, and just compensation.[319] Furthermore, the law prohibits municipal and provincial authorities from applying any tax measures which are confiscatory in nature.[320] Finally, foreign investors are guaranteed the free transfer of funds[321] and have the possibility of utilizing international arbitration for the settlement of investment disputes.[322]

With regards to investment promotion, the new law contains two changes which are noteworthy. First, it allows the government to use incentives in order to attract

[317] *Ibid.* Art 9 [own translation]: "International investments and investors will receive the most favorable treatment of those established in articles 7 and 8 of this law."

[318] *Ibid.* Art 11 [own translation]: "Confiscation will only be decreed or executed in those exceptional cases established in the Constitution; and with respect to international investments and investors, in those cases established by international law. Expropriation of investments, or similar measures, will only take place for a public purpose, following the procedure established for these cases, in a non-discriminatory manner and subject to prompt, just, and adequate compensation...."

[319] *Ibid.* Art 11. This is the famous "Hull Rule" of compensation. This rule was formulated between 1915 and 1940 by U.S. Secretary of State, Cordell Hull, as a result of Mexican expropriation of American property. Developing countries, however, have often rejected the "Hull rule" of compensation and have instead insisted that compensation should be in accordance with national laws. In recent years, developing countries have come to accept the "Hull rule" once again. To better understand this contradiction see generally: A.T. Guzman, "Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties" (1998) 38 Va. J. Int'l L. 639 at 645.

[320] *Ibid.* Art 13 [own translation]: "Provincial and municipal administrations, within their respective jurisdictions, will ensure that their taxes, rates, and contributions on industrial and commercial activity will not affect investments in terms of being confiscatory, or impede the normal course of business."

[321] This right may be limited due to balance-of-payment difficulties. *Ibid.* Art 12. Para. 1. [own translation]: "Transfers may temporarily limited, in an equitable and non-discriminatory manner, in accordance to the internationally accepted criteria, when in the event of extraordinary economic and financial circumstances, the application of this article results or may have negative results on the country's balance-of-payments or international reserves, that is not possible to reverse through any other alternative measure..."

[322] *Ibid.* Art 22 [own translation]: " Controversies that arise between a foreign investor, whose country of origin has a treaty or agreement regarding the promotion and protection of investments with Venezuela, and those controversies to which it is possible to apply the provisions in the Convention for the Creation of Multilateral Investment Guarantee Agency (MIGA) and the Convention on the Settlement of Investment Disputes between states and national of other states (ICSID Convention), will be submitted to international arbitration in the terms in the respective treaty or agreement, when these treaties so establish, this does not affect the possibility to utilize, when it is feasible, the litigious means found in Venezuelan legislation."

investments.[323] These incentives, however, may be subject to the fulfillment of certain performance requirements on the part of investors.[324] Secondly, the new law allows the government to sign what are termed "juridical stability" contracts with investors.[325] Through these contracts, the government hopes to guarantee investors that certain economic conditions will remain unchanged during the life of the contract.[326] These contracts can be signed for a period of up to ten years.[327]

2. Foreign Direct Investment in the Petroleum Industry

In 1992, nearly twenty years after the nationalization of the petroleum industry, the government once again decided to allow foreign participation in this crucial sector of the Venezuelan economy.[328] Two considerations played a major role in the government's

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[323] *Ibid.* Art 15 [own translation]: "The state will establish favorable conditions for investments and investors, with the objective of generally promoting investments, to induce investments in certain sectors and regions, or to create attractive conditions in order to attract investment which contribute to specific national development goals. To this effect, the National Executive through a Decree can:

1) establish benefits or specific incentives to investments made in certain economic branches or sectors, or in those activities which support or stimulate the attainment of policy objectives considered to be of priority;...

3) To condition the enjoyment of a benefit or incentive to the fulfillment of certain actions on the part of investors or the enterprise in which the investment is made..."

[324] *Ibid.* Art 16 [own translation]: " The National Executive will establish specific regimes for the grant of the incentives and benefits referred to in the previous article, or for the establishment of the conditions referred to in subparagraph 3 of the same article. These regimes will take into consideration the way in which the respective investments contribute to specific development goals, and in particular the formation of human capital, productive development, and the insertion of the Venezuelan economy into the global economy..."

[325] *Ibid.* Art 17 [own translation]: " The Republic can celebrate contracts of juridical stability, with the purpose of guaranteeing the investment the stability of some of the economic conditions during the time which the contracts are in force. Such contracts will be made, depending on the sector of economic activity, by the National Competent Authority in charge of the application of the Andean Community norms on foreign capital and can guarantee an investment one or more of the following rights:

1) Stability of the national tax regimes in force at the time the contract was signed.
2) Stability in export promotion regimes.
3) Stability of one or more of the benefits or specific incentives that the investor or the enterprise in which the investment is made has accepted, whichever is the case, in accordance to article 15 of this Decree-Law... "

[326] *Ibid.* Art 17.

[327] *Ibid.* Art 18.

[328] C .Jiménez, "El Programa de Reactivación de Campos Petroleros y los Convenios de Servicios de Operación en Venezuela" in J.C. Carmona, ed., *Temas de Derecho Petrolero* (Caracas: Mc Graw-Hill, 1998) at 55.

decision to open up the oil industry. One, the state-oil company (Petróleos de Venezuela – PDVSA) did not have sufficient resources to undertake the necessary exploration and exploitation. According to government estimates, it would take the state oil company approximately 35 years simply to verify the country's potential reserves.[329] The second consideration was PDVSA's technological limitations.[330] It is estimated that of the country's 310 billion barrels of potential oil reserves, 270 billion barrels are in the form of heavy crude found in the Orinoco Tar Belt.[331] Extracting this crude oil and processing it into commercial products will require foreign technology.[332] The participation of foreign companies will thus be especially valuable in the areas of oil exploration, oil field development, and sophisticated refining techniques.[333]

The participation of foreign oil companies will take place primarily through three mechanisms: 1) operating contracts for the exploration and production in existing oil fields owned by PDVSA; 2) strategic associations for the production of crude and heavy oil in the Orinoco Tar Belt; and 3) profit sharing ventures for the exploration of new areas.[334]

Under operating contracts, private investors bid on concessions to put marginal oil fields in the Orinoco Tar Belt back into production.[335] Concessions are granted for a period of 20 years, with a renewal option.[336] So far there have been three bidding rounds,

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[329] C.E. Padrón, "Proceso de Apertura Petrolera" in J.C. Carmona, ed., *Temas de Derecho Petrolero* (Caracas: Mc Graw-Hill, 1998) at 33.
[330] *Ibid.* at 32.
[331] The Orinoco Belt is found at the north of the Orinoco River in southeastern Venezuela. In an east-west direction it expands approximately 700 km and a north-south direction between 50 and 100kms. See:J. Urdaneta, "Marco Jurídico de la Inversión Privada en la Industria Petrolera. Convenios de Asociación" in J.C. Carmona, ed., *Temas de Derecho Petrolero* (Caracas: Mc Graw-Hill, 1998) at 45.
[332] Jiménez, *supra* note 328 at 32.
[333] Hill, *supra* note 45 at 206.
[334] *ECLAC 1998 Report, supra* note 36 at 125.
[335] *Ibid.*
[336] Jiménez, *supra* note 328 at 62.

with the latest and most successful round taking place in mid-1997.[337] In this round major oil companies paid an estimated $2.06 billion for concessions on 17 out of the 20 oilfields placed on offer.[338] The largest bids came from two European firms: the British firm Lasmo PLC paid an estimated $453 million for the Dacion oilfield, while the Spanish firm Repsol paid $330 million for the Mene Grande oilfield.[339]

In addition to operating contracts, foreign companies can also participate in oil exploration through joint ventures with PDVSA or any of its affiliates. According to article of 5 of the Petroleum Nationalization Law, these joint ventures may only be signed with previous Congressional approval and state-participation must be such as to guarantee its control of the project.[340] Taken these considerations into account, on August 10,1993, Congress approved the first three joint ventures.[341] The first of these joint ventures involved Maraven S.A.(a PDVSA subsidiary) and Conoco Inc., the second involved Maraven S.A. and Total, and the third, Lagoven S.A.(another PDVSA subsidiary) and Shell, Exxon, and Mitsubishi.[342] The first two of these joint ventures involved the exploration, processing, and commercialization of extra heavy crudes from the Orinoco Belt.[343] The third project, the Cristóbal Colón project, involved the exploration and exploitation of offshore gas in northeastern Venezuela.[344] So far the

[337] *Supra* note 36 at 125.
[338] *Ibid.*
[339] *Ibid.*
[340] See in this regard *supra* note 253 and accompanying text.
[341] *Convenio de Asociación entre Lagoven, S.A. y Exxon, Shell y Mitsubishi*, Gaceta Oficial No. 35.293, September 9, 1993.
[342] Urdaneta, *supra* note 331 at 48.
[343] *Ibid.*
[344] *Ibid.*

government has approved a total of six joint ventures with an estimated value of $17 billion.[345]

Finally, foreign corporations may also participate in Venezuela's oil industry through profit-sharing arrangements. Under these profits-sharing arrangements, the risk of oil exploration is borne entirely by the foreign corporation which are given a license to explore in areas where there are potential oil reserves.[346] If oil is found, the company is given a certain percentage of the production in order to recoup exploration expenses and to make a profit.[347] The State also has the right to participate in any future production.[348] Congress approved the conditions for these agreements on July 17, 1995,[349] and PDVSA reached an agreement with the foreign oil companies on July 10, 1996.[350]

The opening of Venezuela's oil industry, however, has not been without difficulties. In December 1995, a group of scholars and lawyers challenged on constitutional grounds the validity of the profit-sharing agreements approved by Congress. These claims were just recently rejected by Venezuela's Supreme Court.[351] In addition, the new energy minister has also voiced displeasure with the opening of the oil

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[345] *ECLAC 1998 Report, supra* note 36 at 126.
[346] Sornarajah, *supra* note 63 at 118.
[347] *Ibid.*
[348] A. Ramírez, "Derecho Petrolero: Nociones Fundamentales y Conceptos Básicos" in J.C. Carmona, ed., *Temas de Derecho Petrolero* (Caracas: Mc Graw Hill, 1998) at 16.
[349] *Acuerdo Mediante el cual se Autoriza la Celebración de los Convenios de Asociación para la Exploración a Riesgo de Nuevas Áreas y la Producción de Hidrocarburos bajo el Esquema de Ganancias Compartidas*, Gaceta Oficial No. 34.754, June 17, 1995.
[350] *Convenios de Asociación para la Exploración a Riesgo de areas Nuevas y la Producción de Hidrocarburos bajo el Esquema de Ganancias Compartidas*, Gaceta Oficial No. 35.988, June 26, 1996.
[351] *Declaratoria sin Lugar del Recurso de Nulidad del Art 2 del Acuerdo del Congreso de la República que Autorizó la Celebración de los Convenios de Asociación para la Exploración a Riesgo de Nuevas Areas y la Producción de Hidrocarburos bajo el esquema de Ganacias Compartidas* (29 August 1999), www.csj.gov.ve/sentencias/CP\ACP-23081999.html (date accessed: 12 January 2000).

industry, which he claims was just a strategy on the part of previous governments in order to privatize PDVSA.[352]

3. Bilateral Investment Treaties (BITs)

In addition to the liberalization that has taken place at the national level, Venezuela has also signed a number of bilateral investment treaties.[353] The object of these treaties is to establish the rules according to which the investment made by nationals of both parties to the agreement will be protected in each other's territory.[354] The basic assumption made by developing countries is that these treaties will help reduce investment risks, thereby encouraging greater investment flows.[355] This basic assumption, however, is yet to be proven.[356] On the other hand, the interest of developed countries in signing these treaties is to provide their investors with the greatest degree of protection.[357] Unlike national laws, BITs can be changed only by both parties through mutual agreement.[358] In addition, through the negotiations of BITs, capital-exporting countries also hope to remove many of the restrictions upon the entry and operation of foreign enterprises found in developing countries.[359]

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[352] P. García, "Debe Desmontarse Internalización y Apertura" *El Universal* (7 February 2000) 2-1.
[353] To date, Venezuela has signed approximately 20 of these treaties. Among the most relevant are those between Venezuela and: 1) Netherlands, Gaceta Oficial No.35.269, August 6, 1993, 2) Argentina, Gaceta Oficial Extra 4.801, November 1, 1994, 3) Switzerland, Gaceta Oficial Extra. 4.801, November 1, 1994, 4) Portugal, Gaceta Oficial Extra. No. 4.846, January 26, 1995, 5) United Kingdom, Gaceta Oficial No. 36.010, July 30, 1996, 6) Spain, Gaceta Oficial No. 36.281, September 1, 1997, 7) Canada, Gaceta Oficial Extra. 5207, January 20, 1998, and 8) Germany, Gaceta Oficial No. 36.383, January 28, 1998.
[354] Sornarajah, *supra* note 63 at 225.
[355] J.W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries" (1990) 24 Int'l Lawyer 655 at 661.
[356] Sornarajah, *supra* note 63 at 236.
[357] Salacuse, *supra* note 355 at 659
[358] *Ibid.*
[359] *Ibid.*

The majority of these treaties are roughly similar in nature. First of all, BITs start out with a definition of the investments covered by the treaty. The list of covered investments includes not only direct investments, but also portfolio investments, real estate investments, claims to money under contract and virtually every type of asset owned by the investor in the host country.[360] Next, BITs specify how foreign investments will be admitted into each country. Most BITs allow host countries to determine the procedure through which they will admit foreign investments.[361] U.S. BITs, however, differ from the majority of BITs in this respect, in that they require the host country to extend national[362] and most favored nation treatment[363] to the pre-establishment phase of this investment.[364] This means that practically every sector of the host country's economy will be opened to U.S. foreign investment.[365] Once the investment is made, BITs require the host country to grant foreign investors a combination of national treatment, most favored nation treatment, and fair and equitable

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[360] *Ley Aprobatoria del Acuerdo entre el Gobierno de la República de Venezuela y el Reino Unido,* Gaceta Oficial No. 36.010, July 39, 1996. *Translated in* ICSID, *United Kingdom/Venezuela,* Investment Promotion and Protection Treaties (Dobbs Ferry, New York: Oceana Publications, 1997).[hereinafter *UK/Venezuela BIT*]. Art 1: "For the purposes of this Agreement:
(a) "investment means every kind of asset and in particular, though not exclusively, includes:
(i) movable and immovable property and any other property rights such as mortgages, liens or pledges;
(ii) shares in an stock and debentures of a company and any other form of participation in a company;
(iii) claims to money or to any performance under contract having a financial value;
(iv) intellectual property rights, goodwill, technical processes and know-how;
(v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources..."

[361] *Ibid.* Art 2(1).

[362] National treatment is that foreign investments be granted equal treatment to national investments. See: *supra* note 356 at 668.

[363] *Ibid.* Most favored nation treatment implies that the investor of one of the contracting parties will receive treatment no less favorable than that which is extended to any other third party.

[364] *Trade and Foreign Direct Investment, supra* note 50 at 39.

[365] T.S. Shenkin, "Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty" 55 U. Pitt L. Rev. 541 at 579. 580. Article II:5 of the U.S. Model BIT reads: "'Neither party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirement."'

treatment,[366] whichever is the most favorable.[367] In this respect U.S. BITs also differ from the majority of BITs in that they expressly prohibit host countries from imposing performance requirements.[368] In addition to these general standards of treatment, BITs protect investors against restrictions on monetary transfers,[369] expropriations,[370] and losses due to armed conflict.[371] Finally, BITs allow foreign investors to have recourse to international arbitration in the case of any investment disputes with the host country. Arbitration may take place either through the International Center for Settlement of Investment Disputes (ICSID) or through an *ad hoc* tribunal established under the

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[366] Salacuse, *supra* note 355 at 667. Despite the fact that this term is often in many BITs, the exact meaning of this phrase is vague. Some consider that this phrase means that the host country must not discriminate against a foreign investor, offer him full protection and security, and treatment no less than that required by international law.

[367] *Ibid.* at 668.

[368] Shenkin, *supra* note 365 at 580. Article II:5 of the U.S. Model BIT reads: '"Neither party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirement."'

[369] *UK/Venezuela BIT, supra* note 360. Art 6: "Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer of their investments and returns. Transfers shall be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the Contracting Party concerned. Unless otherwise agreed by the investor transfers shall be made at the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force."

[370] *Ibid.* Art 5(1): "Investments of nationals or companies of either Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting party except for a public purpose related to the internal need of that Party on a non-discriminatory basis and against prompt, adequate, and effective compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is earlier, shall include interest at a normal commercial rate until the date of payment, shall be made without delay, be effectively realizable and be freely transferable. The national or company affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph...." See also: *supra* note 319 and accompanying text.

[371] It is important to clarify that BITs guarantee that the foreign investor will get compensation equal to that received by national investors, but in no way do they guarantee that the investor will receive compensation in every case. As article 4 of *UK/Venezuela BIT* states: "...Nationals or companies of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to the war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its nationals or companies or to nationals or companies of any third state..." *UK/Venezuela BIT, supra* note 360.

Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).[372]

Although Venezuela has signed a number of these treaties, it has yet to sign a BIT with its largest inward investor, the United States.[373] Werner Corrales, Venezuela's representative to the WTO, has argued that signing this treaty will significantly reduce the country's ability to channel foreign investment towards development goals.[374] Although the country currently does not screen foreign investments or apply performance requirements as a condition on the establishment or maintenance of an investment,[375] it is not possible to determine whether the country will need to utilize such measures in the future.[376] So far, despite continuing pressures from the U.S embassy in Venezuela, negotiations on the treaty seem to have reached a stand-still.[377]

4. WTO Agreements

Despite continuous attempts to create multilateral investment rules, none have been successful. Multilateral investment instruments of a legally binding nature have tended to be rather limited in scope, and those multilateral agreements that contain

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[372] Venezuela is a member of the ICSID since 1995. See: *Ley Aprobatoria del Tratado que Crea el Centro Internacional para el Arreglo de Disputas Relativas a Inversión*, Gaceta Oficial. No. 35.685, April 3, 1996.There have been relative few disputes between investor and the host state which have reached international arbitration. The first such case brought before an ICSID tribunal was in 1987. See: "Asian Agricultural Products LTD. vs. Republic of Sri Lanka" (1991) 30 I.L.M. 577.

[373] Between 1992-1996, the U.S. accounted for approximately 38% of all inward FDI to Venezuela. With the opening of the oil industry this trend is expected to continue. See: *ECLAC 1998 Report, supra* note 36 at 121.

[374] W. Corrales, "Comentarios y Sugerencias para la Reorientación del Tratado Bilateral sobre Inversiones que negocian Republica de Venezuela y los Estados Unidos de América" *El Universal* (29 April 1998) http://www.universal.eud.com/apoyos/tratado.htm (date accessed: 12 December 1998) at 1.

[375] Under the new Law to Promote and Protect Investment, a foreign investor may have to fulfill certain performance requirements but only if he wishes to receive an incentive. *Supra* note 323 and accompanying text.

[376] *Ibid.* at 9.

[377] *Ibid.* at 10.

substantive investment rules have been non-binding.[378] The most recent attempt to create a comprehensive multilateral investment treaty took place within the Organization of Economic Cooperation and Development.[379] The proposed Multilateral Investment Agreement (MAI) was supposed to be a "state of the art" treaty designed to protect and promote foreign investment. Broad discrepancies among OECD negotiators regarding a number of substantive issues[380] and significant public outcry, however, have placed negotiations on hold.[381]

The closest resemblance to a set of multilateral investment rules are found within World Trade Organization (WTO).[382] Prior to the Uruguay Round negotiations, world trade liberalization efforts focused mainly on liberalizing trade in goods.[383] In the Uruguay Round, however, there was a growing recognition of the close relationship between trade and investment.[384] The Uruguay Round produced two Agreements which are particularly significant to foreign investment: the General Agreement on Trade in

[378] *Trade and Foreign Direct Investment, supra* note 50 at 47.

[379] The OECD is made up of mostly developed countries. The following is a list of the 29 members: Germany, Belgium, Denmark, Finland, Hungary, Italy, Mexico, Netherlands, Czech Republic, Switzerland, Australia, Canada, Spain, France, Ireland, Japan, Norway, Poland, United Kingdom, Turkey, Austria, South Korea, United States, Greece, Iceland, Luxembourg, New Zealand, Portugal, and Sweden. See: OECD. *OECD Member Countries* (last modified 5 May 1997) http://www.oecd.org/about/general/member-countries.htm

[380] Among those substantive issues over which OECD countries disagreed were the definition of investment (whether or not it should include portfolio investments), the MAI's coverage (whether to exempt cultural industries or not), the application of the MAI's to subnational authorities, the MAI and regional economic integration organizations, limitations upon the use of incentives, and the settlement of investment disputes. *World Investment Report, supra* note 1 131-135.

[381] *Ibid.* at 136.

[382] It is important to clarify that although the WTO rules which apply to investments are multilateral in scope, they are not part of a comprehensive investment treaty. See: *Trade and Foreign Direct Investment, supra* note 50 at 53-54.

[383] *Ibid.* at 51.

[384] *Ibid.* See also: *World Investment Report 1999, supra* note 1 at 232. According to some estimates, MNEs can account for approximately two-thirds to three-quarters of world exports, and more than a third of world exports would be between affiliated firms.

Services[385] and the Agreement on Trade-Related Investment Measures.[386] As a founding member of the WTO, Venezuela is bound by these Agreements.[387]

(i) General Agreement on Trade in Services (GATS)

The GATS Agreement covers FDI in services by defining trade in services as encompassing the supply of a service through the commercial presence of a service provider in the territory of another Member Country.[388] Three principles of international law: 1) most favored nation treatment (MFN), 2) transparency, and 3) national treatment are the foundation of the GATS Agreement.[389] The MFN principle is the fundamental principle within the GATS. According to the Agreement, each Member Country has the obligation to provide other Member Countries with "treatment no less favorable than that

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[385] "General Agreement on Trade in Services and Ministerial Decisions Relating to the General Agreement on Trade in Services" in UNCTAD, *International Investment Instruments: A Compendium,* Volume 1: Multilateral Instruments (New York and Geneva, 1996) at 247 (UNCTAD/DTCI/30 Vol. I, Sales No. E.96.II.A.9). [hereinafter *GATS Agreement*]
[386] "Agreement on Trade-Related Investment Measures" in UNCTAD, *International Investment Instruments: A Compendium,* Volume 1: Multilateral Instruments (New York and Geneva, 1996) at 279 (UNCTAD/DTCI/30 Vol. I, Sales No. E.96.II.A.9).[hereinafter *TRIMs Agreement*]
[387] Venezuela is a member of the WTO since 1995. The Final Act Embodying the results of the Uruguay Round of Multilateral trade Negotiations became effective in Venezuela as of December 1994. See: Conapri, *supra* note 26 at 16.These agreements are multilateral as opposed to plurilateral trade agreements. The Final Act contains four plurilateral agreements covering Trade in Civil Aircraft, Government Procurement, the International Dairy Agreement, and the Arrangement Regarding Bovine Meat. See: T.J. Dillon, Jr, "The World Trade Organization: A New Legal Order for World Trade?" 16 Mich.. J. Int'l L. 349 at 359.
[388] *GATS Agreement, supra 385.* Art I:2: "For the purposes of this Agreement, trade in services is defined as the supply of a service:
(a) from the territory of one Member to the service consumer of any other Member;
(b) in the territory of one Member to the service consumer of any other Member;
(c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
(d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member..."
See also: E.M. Burt, "Foreign Direct Investment and the WTO" 12:6 Am. U. J. Int'l L. & Pol'y 1015 at 1031. In the agreement the term "commercial presence" is used instead of "commercial establishment" because this last term may create confusion as to whether the service provider has an absolute right of establishment.
[389] Burt, *ibid.*

it accords to services and service supplier of any other country".[390] At the time of entry into force of the Agreement, however, Member Countries were allowed certain exemption from this rule.[391] Besides providing most favored nation treatment, under the GATS Agreement, Member Countries have the obligation of transparency towards other countries. This obligation basically requires Member Countries to publish or notify other Member Countries promptly of any measures which affects trade in services.[392] National treatment, however, is not a general obligation under the GATS Agreement and Member Countries will only be required to extend this treatment in those sectors and modes of supply specified in each Member's schedule of commitments.[393]

Since the conclusion of the GATS Agreement, Member Countries have continued to liberalize services through the negotiations of Protocols. These Protocols modify each Member Country's list of exemptions from Article II (MFN treatment) and their schedule of commitments. In the case of Venezuela, two Protocols are of particular relevance. Under the Fourth Protocol to the GATS concerning basic telecommunications, which entered into effect on February 5, 1998, Venezuela made a commitment to liberalize its local telecommunications network by November 27, 2000.[394] In the Fifth Protocol, which entered into force in March of 1999, Venezuela allows complete foreign ownership (100% equity stake) of banking and insurance institutions.[395] In addition to

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[390] *GATS Agreement, supra* note 385. Art II(1).
[391] *Ibid.* Art II(2).
[392] *Ibid.* Art III.
[393] *Ibid.* Art XVII.
[394] To date this information has not been published in the Official Gazette. The information was kindly provided to us directly by the Ministry of Production and Commerce (Ministerio de la Producción y el Comercio).
[395] *Ibid.* Foreign ownership of banks and insurance companies was first implemented in the General Law of Banks and other Financial Institutions and the Law of Insurance and Reinsurance. See: *Ley General de Bancos y otras Instituciones Financieras,* Gaceta Oficial Extra No.4.641 November 2, 1993 and *Ley de Seguros y Reaseguros,* Gaceta Oficial Extra. No. 4.822, December 23, 1994.

these Protocols, the Services Council in February of this year launched formal negotiations to further liberalize trade in services.[396]

(ii) Agreement on Trade-Related Investment Measures (TRIMs)

The TRIMs Agreement was another significant step towards the creation of a set of comprehensive investment rules within the WTO. As broadly defined, TRIMs are performance requirements that affect trade flows.[397] During the Uruguay Round negotiations, however, there were broad discrepancies as to exactly which performance requirements affected trade.[398] Developed countries, on the one hand, argued for a broad all encompassing definition of TRIMs.[399] According to these countries, TRIMs would include the whole array of investment measures utilized by developing countries such as local content requirements,[400] domestic manufacturing requirements,[401] foreign exchange restrictions,[402] trade balancing requirements,[403] domestic sales requirements,[404] export performance requirements,[405] product mandating requirements,[406] technology transfer

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[396] WTO, "Service Negotiations Formally Launched" (10 March 2000) http://www.wto.org/wto/new/servfeb.htm (date accessed 21 March 2000).
[397] *Formulation and Implementation of Foreign Investment Policy, supra* note 95 at 40.
[398] *Ibid.*
[399] PB. Christy III, "Negotiating Investment in the GATT: A Call for Functionalism" (1991) 12 Mich. J. Int'l L. 743 at 779.
[400] Local content requirements require that foreign investor use a certain amount of local supplies, raw materials, and services in his final product. See: E.M.A Kwaw, "Trade Related Investment Measures in the Uruguay Round: Towards a GATT for Investment?" (1991) 16 N.C.J. Int'l L. & Com Reg. 309 at 319.
[401] Domestic manufacturing requirements place an obligation on the foreign investor to fabricate a certain number of his inputs locally. Christy III, *supra* note 399 at 779.
[402] The foreign investor is only granted an amount of foreign exchange equal to the amount he exports. *Ibid.*
[403] Trade balancing requirements place an obligation on the foreign investor to export a quantity equal to his imports. *Ibid.*
[404] Place an obligation on the foreign investor to sell a certain amount of his output on the local market. *Ibid.* at 780.
[405] Require the foreign investor to export a certain amount of his production. *Ibid.*
[406] Require the foreign investor to grant that particular investment certain exclusive rights to export markets or requires the foreign investor to export to certain markets. *Ibid.*

requirements,[407] local equity requirements,[408] licensing requirements,[409] manufacturing restrictions,[410] remittance restrictions,[411] and incentives.[412] Developing countries, on the other hand, argued for a much more restricted definition of TRIMs. According to these countries, the only investment measures which have a direct impact on trade are local content requirements, export requirements, and trade balancing requirements.[413] Furthermore, developing countries also argued that performance requirements are necessary not only to pursue development goals, but also to counter restrictive business practices on the part of MNEs.[414] The limited number of performance requirements banned by the TRIMs Agreement attest to the pressure developing countries exercised throughout the negotiations.[415]

The final TRIMs Agreement prohibits only those investment measures which violate article III (national treatment) and article XI (prohibition on quantitative restrictions) of the GATT.[416] The annex to the TRIMs Agreement provides an illustrative list of the types of measures which violate the Agreement. Among those investment measures that violate a country's national treatment obligations are local content

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[407] Require the investor to include certain technology in their production process or to undertake a certain amount of research in the host country. *Ibid.*
[408] Require local investors to own a certain equity stake in foreign enterprises. *Ibid.*
[409] Require the foreign investor to license the production, use, or sale of a certain technology to local enterprises. *Ibid.*
[410] Prevent the foreign investor from manufacturing certain products. *Ibid.*
[411] Limit the amount of capital or profits a foreign investor may repatriate. *Ibid.*
[412] Certain advantages offered by the host country in order to lure investors or to make them comply with host country performance requirements. *Ibid.*
[413] Kwaw, *supra* note 400 at 329.
[414] *Ibid.* A perfect example of such a practice is tied selling. Tied selling are restrictions placed by a parent company on the parties with whom its foreign affiliate can trade. Tied selling may limit a subsidiary's exports, or it may require that a subsidiary purchase its inputs from its parent company instead of local sources. See also: Burt, *supra* note 388 at 1022.
[415] *Ibid.* at 1035.
[416] *TRIMs Agreement, supra* note 386. Art 2.

requirements and trade balancing requirements.[417] Those which violate a country's prohibition of using quantitative restrictions are trade balancing requirements, foreign exchange restrictions, and domestic sales requirements.[418]

The final TRIMs Agreement offers developing countries slightly more preferential treatment than developed countries. Article 4 of the Agreement allows developing countries to reinstate prohibited measures on an interim basis when a country is facing balance of payments difficulties.[419] Developing countries are also given a greater time period over which to phase out non-conforming measures. While developed countries are given a period of two years to phase out non-conforming measures, developing countries are given a period of five years, and the least-developed countries are given a period of seven years.[420]Therefore, all Member Countries should be compliance with the Agreement by the year 2002.

The TRIMs Agreement is only a first step towards the liberalization of investment rules within the WTO. In the future, developed countries will want to expand the scope of the TRIMs Agreement to include such investment measures as local equity requirements, technology transfer and licensing requirements, local employment requirements, and export requirements.[421] Some developing countries, including Venezuela, have already made it known that they will only support an investment agreement within the WTO that does not limit the right of developing countries to use

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[417] *Ibid.* Annex: 1(a)
[418] *Ibid.* Annex: 1(b)
[419] *Ibid.* Art 4.
[420] *TRIMs Agreement, supra* note 386. Art 5. The TRIMs Agreement entered into effect as of January 1, 1995.
[421] Kwaw, *supra* note 400 at 1039.

performance requirements.[422] Given the current backlash against globalization, it will probably be difficult for developed countries to make significant advances towards liberalizing investment rules within the WTO.[423]

IV. Challenges Posed by Liberalization

A. Attracting Greater FDI Inflows

The last few years have not been kind to the Venezuelan economy. From 1976 to 1996, per capita GDP decreased at an annual rate of O.O4 %.[424] During this time, Venezuela went from being the country with the highest per capita income in Latin America to occupying the eight spot.[425] Worldwide, the country dropped from the 29th spot to the 51st spot.[426] Recent figures have not been too encouraging either. In 1999, GDP dropped by 7.2%, the second largest drop in the last twenty years.[427]

Injecting momentum back into the Venezuelan economy will no doubt require a large amount of resources. It has been calculated that if Venezuela's per capita GDP is to compare by the year 2020 to Israel's current GDP (approximately $16000), investment

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[422] "Requisitos de Desempeño, el Gran Logro" *El Universal* (22 August 1999) http://www.universal.eud.com/1999/08/22/22204BB.shtml (date accessed: 30 March 2000). Other developing countries which have rejected the prohibition of performance requirements in the WTO are the Philippines, Malaysia, Egypt, India, and Pakistan.

[423] The 3rd Seattle WTO Ministerial Conference which took place in Seattle between November 29 - December 3 was supposed to launch the latest round of trade negotiations, the so-called "Millenium Round". From its beginning this Conference was met by strong opposition from labor, environmental, human rights and other non-governmental organizations (NGOs). On December 3, WTO Director General Michael Moore, declared that negotiations had failed to launch the new negotiations round due to a lack of consensus among WTO Members. There is no doubt, however, that pressure from NGOs had some influence over the final results. See: Public Citizen, "World Trade Organization" (5 December 1999) http://www.citizen.org/pctrade/harmonizationalert/November99/seattle.htm (date accessed: 2 May 2000). See also: Comunidad Andina, "Dialogo, Consenso y Cooperación: La UNCTAD X y el "Espiritu de Bangkok"" (March 2000) http://www.comunidadandina.org/document\estu\unctad.htm (date accessed: 10 April 2000).

[424] Francés, *supra* note 272 at 55, 99. Venezuela's per capita GDP in 1997 was $3450.

[425] *Ibid.* at 55.

[426] *Ibid.*

[427] L.A. Maracara, "Desempleo Alcanza Máximo Histórico" *El Universal* (24 February 2000) 2-4.

will need to be maintained at approximately 25% of GDP over the next twenty years.[428] No doubt public investment will play an important role, but in the future more of these resources should come from the private sector. Within this private sector, FDI can make a valuable contribution to the country's economy.[429] In addition to providing a valuable infusion of capital into the host country's economy, FDI also provides host countries with other valuable resources.[430] Some of these resources, as is often the case with technology, are exclusive to MNEs and may not be obtained through other channels.[431] Attracting FDI, however, in a setting in which more countries are competing for this type of investment is not an easy task.[432]

As the recent example of Venezuela illustrates, the simple liberalization of investment laws will not be sufficient to attract greater FDI flows.[433] Attracting greater foreign investment flows will require improving the country's overall investment climate. This investment climate is composed of three aspects: 1) an institutional aspect, which among other things, includes the political and economic stability of the host country; 2) a legal aspect which is composed not only of the substantive rules affecting foreign investment, but also the legal remedies available to foreign investors; and 3) an infrastructural aspect which are the human and physical resources available to the foreign

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[428] Francés, *supra* note 272 at 98.
[429] See in this regard *supra* note 82 and accompanying text.
[430] For an explanation of the benefits FDI provides see *supra*, Part II, "Costs and Benefits of FDI".
[431] *World Investment Report 1999, supra* note 1 at 316.
[432] *World Investment Report 1998, supra* note 43 at 57. According to UNCTAD, of a total 151changes made in FDI regulation in 1997 by 76 countries, 87% were intended to create more favorable conditions for foreign investment.
[433] Over the last two years, Venezuela has experienced a decrease in FDI inflows. After reaching a high of $5 billion in 1997, FDI inflows have dropped to $2.7 billion in 1999. This at a time when inflows to most Latin American countries have increased. See: *supra* note 40.

investor.[434] Throughout this section we will look at some of the adjustments Venezuela can make in order to improve its overall investment climate.

1. Increase Political and Economic Stability

One of the factors that greatly deteriorates Venezuela's investment climate is the lack of political and economic stability. The 1990s were a decade of great political and economic uncertainty for the country. In 1992, after only three years of market-oriented reforms, there were two coup attempts against Carlos Andrés Pérez's administration.[435] One of them was led by a little-known military officer named Hugo Chávez Frías. The military uprisings put a halt to three years of impressive economic growth for the country.[436] The following year, Pérez was removed from office under corruption charges. His successor, Rafael Caldera, was elected on the promise of reversing the economic reforms begun in 1989, which he effectively did in 1994 and 1995.[437] In 1996, however, due to severe macro-economic imbalances, Caldera's government was forced to sign a stand-by agreement with the International Monetary Fund (IMF) for $1.4 billion.[438] As part of this stand-by agreement, Venezuela agreed to implement a package of tough economic reforms, which were given the name of the Venezuelan Agenda (Agenda Venezuela).[439] These economic reforms were aimed at reducing the fiscal deficit, lowering inflation, and improving the country's balance-of-payments account.[440] Judged

[434] Shihata, *supra* note 278 at 678 –684.
[435] Francés, *supra* note 272 at 58. See also in this regard *supra* note 294 and accompanying text.
[436] V. Salmeron, "La Economía cayo 7.2% este año y la Inversión Privada 23.4%" *El Universal* (26 December 1999) 2-1. In 1991, the economy grew at an impressive 9.7%. In 1992, despite the coup attempts, in 1992, GDP growth was 6.1%
[437] Francés, *supra* note 272 at 58.
[438] "La Agenda Venezuela" *El Universal* (27 May 1999) http://universal.eud.com/apoyos/venezu.htm (date accessed: 3 February 2000) at 2.
[439] *Ibid.*
[440] *Ibid.* at 6.

strictly on economic growth, the Venezuelan Agenda seemed a great success. In 1997, one year after its implementation, the economy grew at an impressive 5.9%.[441] However, the Agenda failed to lower excessive public spending which that year was fueled by high oil prices, and to curve inflation.[442] In 1998, as a result of lower oil prices, the economy once again slid into a recession experiencing a negative growth of 0.7%.[443] In 1999, Rafael Caldera was succeeded by Hugo Chávez Frías, the same man who, seven years earlier, had failed to overthrow Pérez's government. During his first year in power, most of Chávez's attention has been centered on the drafting of a new constitution, which was finally approved on December 15, 1999.[444] Amidst the political turmoil generated by the drafting of the new constitution, the country slipped into one of its worst recessions in years. In 1999, GDP dropped by 7.2% and unemployment rose to 15.4%[445](some figures have place unemployment figures even higher at 18.4%).[446] So far, however, the government seems to have little response to the economic crisis and is yet to present a coherent economic program.[447]

On July 30 and October 1, 2000, elections will be held to elect the new authorities under the recently sanctioned Constitution.[448] Regardless of the results, the new government will face the tough task of reactivating the economy. The economy,

[441] Maracara, *supra* note 436 at 2-4.
[442] W. Sandoval, "La Agenda Venezuela no logró Equilibrios Macroeconómicos" *El Universal* (25 November 1998) http://universal.eud.com/1998/11/25/25201AA.shtml (date accessed: 20 March 2000)
[443] Salmeron, *supra* note 436 at 2-1.
[444] *Constitución de la República Bolivariana de Venezuela,* Gaceta Oficial No. 36.860, December 30, 1999 [hereinafter *1999 Constitution*].
[445] Salmeron, *supra* note 436 at 2-1.
[446] *Supra* note 427.
[447] R. Marotta, "Discurso Político de Chávez impide Exito de Programa Económico" *El Universal* (29 March 1999) http://politica.eud.com/1999/03/29/260399a.html (date accessed: 22 March 2000).
[448] Elections were originally scheduled to be held on May 28, but due to alleged mismanagement on the part of the electoral authorities they were later postponed. On July 30, elections will be held for national and provincial authorities, while municipal authorities will be elected on October 1. L. Colomine, "Sin

however, will not be able to recuperate if the new government does not create a stable political and economic climate in which investments (both foreign and national) can take place.[449] A great part of creating this climate will be the formulation of a clear economic program. This program should clearly outline the future economic and social goals of the government and the policies necessary to achieve these goals. In addition, it should be designed with a long-term view of the necessities of the country, in order to ensure that there is some consistency in economic policies. This consistency is particularly valuable to investors who normally require a long-term view of the market in order to make a fair assessment of the potential risks of their investment.[450] As a recent government report stated : "in the measure that economic conditions and institutions are stable, they will also be predictable and, therefore, contribute to lowering risk and uncertainty, thereby creating ideal conditions for entrepreneurial activity and investment."[451]

2. Reduce Crime

One of the problems the government will have to solve in order to attract greater foreign investment flows is the country's growing crime problem. According to recent figures, Venezuela now holds the dubious honor of being the sixth most dangerous country in the world, behind Colombia, South Africa, Mexico, Brazil, and Russia.[452] So far the crime problem has affected all segments of the population, from the humble citizen all the way to big businesses. Recently, a large American MNE (Procter &

Consenso se Aprobó Separación de las Elecciones" *El Universal* (23 June 2000) http://archivo.eud.com/2000/06/23/23110AA.shtml (date accessed: 27 June 2000).

[449] Venamcham, "Reporte del Comité Económico de VeAmCham" (13 January 2000) http://www.venamcham.org/espanol/crl2ke.html (date accessed: 20 March 2000).

[450] Procompetencia, "El Crecimiento Económico y la Promoción de la Competencia en el Contexto de la Actual Coyuntura Nacional" http://procompetencia.gov.ve/crecimientoeconomico.html (date accessed: 9 April 2000) at 9.

[451] *Ibid.* The translation of the original text is ours.

Gamble) threatened to move its operations out of the country if the government did not take actions to solve the problem.[453] One of the chief complaints of this firm was that the growing insecurity was not only making it difficult for the company to carry out its normal business activities, but it was also making it difficult for the company to attract high-quality personnel into the country.[454]

One of the most commonly cited reasons for the high crime rate is the promulgation of a new Criminal Procedure Code which, according to some, offers too many advantages to criminals.[455] This, however, is an oversimplification of the problem. Any solution to the crime problem will have to move beyond the simple adjustment of procedural rules and to address the real causes behind the growing crime rate such as the high poverty[456] and unemployment levels.[457] A recent study by Fedecamaras (the Venezuelan chamber of commerce) states that any solution to the crime problem will have to include: 1) social measures aimed at reducing high poverty and unemployment levels, 2) educational measures aimed at providing a higher quality education and imparting higher moral standards, 3) police measures aimed at preventing crimes and raising the police force's morale, and 4) judicial measures aimed at extinguishing corruption in tribunals and ensuring faster trials for those accused of committing crimes.[458]

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[452] M. León, "Transnacionales Contemplan irse de Venezuela" *El Universal* (2 March 2000) 2-1.
[453] *Ibid.*
[454] *Ibid.*
[455] *Ibid.* See also: Código Orgánico Procesal Penal, Gaceta Oficial Extra No. 5.208, January 23, 1998.
[456] According to recent estimates between 60 and 80% of the Venezuelan population lives in poverty. Francés, *supra* note 272 at 63.
[457] See also in this regard *supra* note 446 and accompanying text.
[458] P. Carmona, "La Inseguridad en Venezuela" *El Universal* (19 February 2000) http://www.universal.eud.com/2000/02/19/00010.shtml (date accessed: 20 March 2000)

3. Create an Honest and Efficient Judicial Branch

The creation of an honest and efficient judiciary is another critical aspect in attracting foreign investment. Without an effective administration of justice, it is very difficult for a market economy to function.[459] Transactions in such an economy are often based upon the guarantee creditors have that they can always enforce their rights through the courts if their debtors fail to voluntarily comply with their obligations. Without such a guarantee, the number of transaction in the marketplace is greatly reduced and there is little incentive to invest.[460]

Since 1996, the Venezuelan government has taken a number of steps to improve the efficiency of its judicial branch.[461] A first reform taken, with the help of the World Bank (which will donate approximately $35 million), has been to furnish tribunals with more modern equipment and infrastructure.[462] Another reform has been to establish more specialized tribunals.[463] In the past, a single tribunal would hear cases, for example, in civil, commercial, and labor matters. With the current reform, the objective is to reduce a tribunal's workload by restricting the number of affairs over which it has jurisdiction. In addition, the state is also encouraging private parties to utilize justices of the peace to settle controversies of less monetary value.[464] Finally, the recent approval of the Commercial Arbitration Law should help take some off the burden off State tribunals.[465]

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[459] Francés, *supra* note 272 at 254.
[460] *Ibid.*
[461] R. Perdomo, "Cual Reforma Judicial" *El Universal* (3 December 1996) http://universal.eud.com/1996/12/0327344.shtml (date accessed: 6 May 2000).
[462] E. López, "Banco Mundial ratifica Apoyo a la Reforma Judicial" *El Nacional* (8 June 1999) http://el-nacional.com/archive/index2.asp (date accessed: 5 May 2000).
[463] Francés, *supra* note 272 at 253.
[464] *Ley Orgánica de Justicia de Paz*, Gaceta Oficial No. 4.817, December 21, 1994.
[465] *Ley de Arbitraje Comercial*, Gaceta Oficial No. 36.430, April 7,1998. The new law hopes to encourage the use of arbitration by making it easier for private parties to include arbitration clauses in their contracts

This, however, leaves us with one of the biggest problems of the judiciary, the corruption of judges.[466] Although the majority of people consider that there is a great deal of corruption in the judicial branch, relatively little progress was made over the years to remedy the situation.[467] Charges against corrupt judges would often get bogged down in an endless maze of bureaucratic procedures.[468] Faced with this problem, Venezuela's new government decided to take drastic steps to remedy the situation. On August 18, 1999, the National Constitutional Assembly, the organ which was in charge of drafting the country's new constitution, issued a controversial decree which declared the judicial power in a state of emergency.[469] This controversial decree called for the immediate suspension of all judges currently being investigated on corruption charges.[470] In addition, the decree also created a special commission with the power to remove judges from office.[471] In all, a total of 377 judges were suspended, and 75 judges were removed from office.[472] To put these measures into perspective, consider that prior to the declaration of the state of emergency, Venezuela only had around 1114 judges.[473]

The removal of corrupt judges, however, is only an initial step to creating a more honest judicial branch. Another step has to be the creation of more demanding

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and by limiting state intervention in arbitral proceedings. See: J. Muci-Abrahan, "Privatización de justicia" *El Nacional* (2 Junio 1998) http://www.el-nacional.com/archive/index2.asp (date accessed: 20 June 2000).

[466] *Ibid.*

[467] R. Perdomo, "La Alta Comisión de Justicia y la Reforma Judicial" *El Universal* (4 March 1997) http://universal.eud.com/1997/03/04/38905.shtml (date accessed: 5 May 2000).

[468] *Ibid.*

[469] *Decreto de Reorganización del Poder Judicial,* Gaceta Oficial No. 310.498, August 25, 1999.

[470] *Ibid.* Art 6.

[471] *Ibid.* Art 7. According to article 7 of the Decree, the Judicial Emergency Commission has the faculty to remove judges from office under the following circumstances: [own translation] "...A) When the judges have been, in the judgment of the Judicial Emergency Commission, excessively slow in their judgment of cases. B) When a judge's sentences have been constantly revoked, in the judgment of the Judicial Emergency commission, due to an evident lack of knowledge of the law. C) When the judges, district attorneys and other court officials commit serious breaches in the fulfillment of their obligations. D) When the judges, district attorneys and other court officials possess riches whose origin cannot be demonstrated."

[472] I. Alvarez, "Suspenden 83 jueces y destituyen a 28" *El Universal* (30 March 2000) at 1-15.

procedures for the selection of judges.[474] The new Constitution makes some changes in this respect, in that it calls for greater public participation in the selection of judges.[475] The rules that establish the procedure by which the public will participate in the selection of judges, however, has still not been developed. Another important step in creating a more honest judicial branch is to raise salary levels. In March of this year, an important step was taken towards this goal when judges received a 40% increase in their salaries.[476]

4. Raise Education Standards

One of the most important assets a host country can now offer foreign investors is a highly qualified labor force.[477] Countries with a highly qualified labor force have not only been able to attract greater investment levels, but have also been able to gradually entice foreign investors to place more complex activities in their territory.[478] It is no secret that the quality of a country's human resources are directly linked to the quality of its education system.[479] Venezuela's education system, however, leaves a lot to be desired. In one study done by the United Nations, Venezuelan children ranked among the last in reading proficiency examinations. Their scores were only better than similar children in Mozambique and Angola.[480] In the 1997 World Competitiveness Report, Venezuela's primary education system was rated the worst of all those countries

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[473] López, *supra* note 462
[474] Perdomo, *supra* note 461.
[475] *1999 Constitution, supra* note 444. Art 255.
[476] Alvarez, *supra* note 472 at 1-15. Prior to this increase, judges monthly salaries ranged from approximately $769.23 to $2030. E. López, "Nuevos Jueces ganaran el Doble del Sueldo de sus Predecesores" *El Nacional* (5/1/2000) http://www.el-nacional.com/archive/index2.asp (date accessed: 28 June 2000).
[477] *UNCTAD Series, supra* note 13 at 48.
[478] *World Investment Report 1999, supra* note 1 at 280.
[479] *Ibid.*
[480] J.L. Cordeiro, "La 'Africanización' de la Educación 'Benesuelana'" (15 June 1999) http://universal.eud.com/1999/06/15/0009.shtml (date accessed: 4 May 2000) at 1.

considered in the study.[481] If Venezuela is not able to reverse this disturbing trend, it will be difficult not only to attract foreign investment, but to achieve any type of sustained economic growth.[482]

All firms tend to provide some form of on the job training. MNEs, however, tend to be more conscious of the benefits of having a well-trained staff and normally have sophisticated training systems.[483] In addition, foreign affiliates have access to the wide array of resources in their corporate system. They are able to transfer trainers from other affiliates, to access other affiliate's information, or even to transfer employees from one affiliate to another for training.[484] Foreign affiliates can also encourage other firms, most notably their suppliers and buyers, to adopt similar practices.[485] They can work with local institutions in improving the quality of education, they can encourage governments to establish training facilities, or they may even encourage institutions in their countries to establish training facilities abroad.[486] However, the amount of training a firm can provide is directly related to the initial quality of the country's human resources. In those countries in which the educational base is high, firms will have greater incentives to provide additional training and to constantly upgrade their technological capacity.[487]

In this respect, Venezuela still has a long way to go before the quality of its labor force is to match that of more developed countries. One of the first steps that has to be taken is to combat the high abandonment rate that is currently plaguing our school

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[481] *Ibid.*
[482] *Ibid.*
[483] *World Investment Report 1999, supra* note 1 at 274.
[484] *Ibid.*
[485] *Ibid.*
[486] *Ibid.*
[487] *Ibid.* at 273.

system.[488] In Venezuela only 21% of the labor force has a high school diploma.[489] This compares poorly against countries like Korea in which 43% of the working population has a high school diploma.[490] One of the possible solutions to the high desertion rates may lie in providing children with food at school, thus taking some of the economic burden off their parents.[491] The quality of the labor force, however, will not improve without correcting problems in the education system. One of the biggest problems plaguing the country's education system is not a lack of funds, but the unequal distribution of those funds. According to recent estimates, Venezuela is one of the countries in Latin American which spends the least amount of resources in its primary and secondary education.[492] Conversely, it is one of the countries in the world that spends the highest percentage of its educational budget on tertiary education.[493] In the future, Venezuela will have to reduce its expenditure on higher education. Two possible solutions to this problem might be to reduce the number of university students by creating more selective admission procedures and to lower government expenditure by transferring a larger share of the educational expense upon students.[494] Scholarships can be awarded to those students who are qualified, but do not have the necessary resources.[495] By reducing its expenditure on tertiary education, the government will then be able to invest more resources in the country's primary and secondary education which

[488] Francés, *supra* note 272 at 228.
[489] *Ibid.* at 227.
[490] *Ibid.*
[491] *Ibid.* at 219. In Venezuela such a program currently exists, but the program has to be expanded and its quality improved. In 1997, it was estimated that approximately one million children were served breakfast at school and approximately twenty-five million lunches were served in school cafeterias.
[492] Procompetencia, "Formulación de Políticas de Eficiencia y Equidad en el Sector de Educación" (1999) http://www.procompetencia.gov.ve/informesectoreducacion.html (date accessed: 12 March 2000) at 4.
[493] It is estimated that Venezuela spends at least half of its educational budget on higher education. Francés, *supra* note 272 at 220.
[494] *Ibid.* at 231.
[495] *Ibid.*

are in desperate need of improvement.[496] Finally, programs have to be created to cater to the specific needs of businesses.[497] In Venezuela, the demand for workers with technical skills has constantly exceeded the supply.[498] In the future, the government will have to work closer with firms in order to ensure that the education students receive is closely tied to the needs of firms.

5. Improve Infrastructure

Venezuela will also need to improve its existing infrastructure facilities in order to attract greater foreign investment flows. Good infrastructure facilities are particularly important for those foreign enterprises interested in establishing export-oriented activities.[499] Although Venezuela has one of the best roadway systems in Latin America, the majority of these roads have become dated and are in desperate need of maintenance.[500] According to estimates done by the Venezuelan Construction Chamber, during the 1990s most of the governments in Latin America invested approximately 3% of their GDP on infrastructure projects, while Venezuela invested less than 1%.[501] This means that during the 1990s, the government should have spent approximately $30 billion more on infrastructure.[502]

In addition to repairing the existing infrastructure, Venezuela will have to make important investments in new infrastructure facilities. One of the most pressing needs is

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[496] A recent assessment of the country's education system concluded: [own translation] "The inefficient allocation of resources fosters a shortage in the supply of education at the basic, secondary and technical levels. Likewise, this situation reduces the amount of students that schools can accept and inhibits the ability to pay teachers competitive wages in accordance to their productivity, which in turn affects the quality of education." Procompetencia, *supra* note 492 at 5..
[497] *Ibid.* at 7.
[498] *Ibid.*
[499] *ECLAC 1998 Report, supra* note 43 at xxxiii.
[500] Francés, *supra* note 272 at 179.
[501] W. Sandoval, "Se deben $30 Millardos en Construcción" *El Universal* (17 April 2000) at 2-1.

the construction of an extensive railway system (Venezuela currently has one of the shortest railway systems in Latin America).[503] This railway system will take some of the burden off of Venezuelan roads and thus help conserve them for longer periods of time. Another important project is the construction of an extensive waterway system through southern Venezuela. This waterway system will help to reduce cargo costs by directly linking the eastern and western parts of the country.[504] Currently, most of the traffic and cargo between these two parts of the country has to pass through the northern section of the country.[505] The construction of this waterway, which is possible due to the large number of rivers that exist in this region (the largest being the Orinoco River) will permit the development of the country's vast interior region which, so far, has not been exploited.[506] Due to the high capital requirements of some of these projects, the government can consider the participation of foreign firms under concession programs.[507]

6. Utilize Incentives

In addition to aforementioned measures, any attempt by Venezuela to attract foreign investment flows will have to consider the use of incentives. These may basically take three forms: 1) financial incentives, which involve the direct transfer of funds to the foreign investor; 2) fiscal incentives, designed to reduce the tax burden on the foreign investor; and 3) indirect incentives, which are designed to indirectly increase the foreign investor's profit (i.e. the government may provide land and infrastructure at less than

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[502] *Ibid.*
[503] *Ibid.* at 181.
[504] *Ibid.* at 177.
[505] *Ibid.* at 178.
[506] *Ibid.* at 178.
[507] Sandoval, *supra* note 501. According to Venezuela's Construction Chamber, the country's capital market does not have the capacity to finance investment projects whose costs exceed $270 million.

commercial prices).[508] So far the type of incentives offered by the Venezuelan government have taken only the form of fiscal incentives. The Income Tax Law[509] offers companies making investments in the petroleum industry and other related activities (i.e. refining, transportation, and gas exploration), a tax reduction equivalent to 8% of their annual investment.[510] Investments made in the industrial, agro-industrial activities, construction, electricity, telecommunications, and generally any other industrial activity outside of the petroleum industry, benefit from a tax reduction equivalent to 10% of the annual investment.[511] This incentive, however, will only be available for a period of five years after the date of entry into force of the Law.[512] For investments made in tourism, the investor can receive a tax reduction equivalent to an amount of 75% of his annual investment.[513] In agriculture, cattle, and fishing activities, the reduction will be of up to 80% of their annual investments when those investments also contribute to the surrounding community.[514] In addition, the Law to Promote and Protect Investments, also gives the President the faculty to decree income tax reductions or exemptions for investments made in certain areas of economic activity or regions of the country considered to be of importance to the economic development of the country.[515]

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[508] *Trade and Foreign Direct Investment, supra* note 50 at 32.
[509] *Ley de Impuesto sobre la Renta,* Gaceta Oficial Extra. No. 5.390, October 22, 1999.
[510] *Ibid.* Art 56.
[511] *Ibid.* Art 57.
[512] *Ibid.* The Income Tax Law entered into force in 1999, therefore this benefit will expire in the year 2004. See: *supra* note 509.
[513] *Ibid.* Art 57. Para.1.
[514] *Ibid.* at 57. Para.3.
[515] *Law to Promote and Protect Investments, supra* note 312. Art 15. See also: Conapri, *Legal Regime for Foreign Investment in Venezuela* (June 2000) http://www.conapri.org/dowload/LegalRegime.pdf (date accessed: 25 June 2000) at 102.

Municipal authorities also have the faculty to offer investors certain tax breaks from municipal taxes,[516] but these types of incentives are not common.

Although incentives are currently part of Venezuela's policy to attract foreign investments, their potential to have a negative impact on the country's economic development should not be underestimated. By utilizing incentives, the host country reduces the benefits it would have received from an investment.[517] In the case of Venezuela which utilizes fiscal incentives, that loss is represented by a reduction in income taxes. The use of incentives, however, does not guarantee that the country will receive greater investment flows since other countries can also utilize incentives thereby eliminating another country's advantage.[518] Host countries are therefore caught in what is called a "prisoner's dilemma", in which each country would benefit the most if they refrained from using incentives, but where each country still benefits from using incentives regardless of the other's conduct.[519] Therefore, host countries in their competition for investment destroy what would be the best possible solution in which none of them use incentives and receive the entire benefit from investments, but instead end up with the worst possible solution, in which every country uses incentives with little or no gain in the amount of investment they receive.[520] In the end, foreign investors are the ones who gain the most from this competition between countries.

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[516] Conapri, "Incentivos a la Inversión" (August 1999) http://www.conapri.org/webespanol/incentivos.html (date accessed: 16 March 2000)
[517] *Trade and Foreign Direct Investment, supra* note 50 at 33.
[518] *Ibid.*
[519] Incentives may grant a country an advantage in attracting foreign investment flows over another country that does not utilize them. The country that does not utilize incentives, however, may easily erase this advantage by also utilizing incentives. *Ibid.*
[520] *Ibid.*

The ideal solution for Venezuela and other countries would be to sign a treaty which restricted the use of incentives.[521] Such a treaty, however, would be difficult to enforce since there will always be the temptation for countries to break the treaty's rules in order to gain an advantage over the other countries.[522] In the absence of such a treaty, the best option for Venezuela is still to utilize incentives in a careful manner. Incentives should only be utilized after a detailed analysis of the costs incentives represent and the benefits expected from an investment.[523] Instead most of the country's efforts towards attracting foreign investment should focus on improving the country's overall investment climate. Foreign investors will not invest in countries with an unstable political climate, poor macroeconomic conditions, poor infrastructure facilities, and poor human resources simply for an attractive investment package. As one prominent study stated: '"It is evident that incentives are of some importance, particularly those provided via trade policy and tax measures. On the other hand, most firms are acutely aware of difficulties posed by such incentives and frequently assert that they are reluctant to undertake projects that are heavily dependent for their success upon the incentives provided by the host country.'"[524]

Suggesting that countries should avoid competing for FDI through the use of incentives does not mean, however, that countries should not make every effort to promote their country as an attractive investment location. These promotional efforts should be aimed at providing foreign investors with all general information about the host country (i.e. economic data, industry profiles, investment opportunities, privatization

[521] *Ibid.* at 35.
[522] See: Guzman, *supra* note 319 at 678.
[523] *Formulation and Implementation of Foreign Investment Policies, supra* note 95 at 55.
[524] Moran, *supra* note 67 at 98.

programs), investment laws, incentives, and administrative procedures for foreign investors.[525] Since 1990, the Consejo Nacional de Promociones (Conapri) has been the agency in charge of promoting FDI in Venezuela.[526] Conapri is a non-governmental organization composed of representatives of both the private and public sector. In addition to providing useful information to foreign investors, the organization is designed to serve as a link between the private and public sector, and to offer government advice on the formulation of foreign investment policies.[527]

B. Extracting the Maximum Benefits from FDI

While efforts should be made to attract foreign investments, Venezuela needs to remember that in some cases FDI can have a negative impact on the host country's development. In particular Venezuela needs to guard itself against the possible negative effects FDI may have on the domestic market structure, the use of restrictive business practices on the part of MNEs such as transfer pricing, and the impact of FDI on the country's balance of payments.[528] In addition, policies have to formulated to in order to ensure the development of domestic firms. In this section, we will examine how Venezuela can maximize FDI's contribution to the country's economic development.

1. Maintain a Competitive Domestic Market

The ultimate objective for developing countries in attracting FDI is to promote economic development in their countries.[529] Achieving this objective, however, requires

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[525] *World Investment Report 1999, supra* note 1 at 182.
[526] Conapri, *supra* note 26.
[527] *Ibid.*
[528] *World Investment Report 1999, supra* note 1 at 176.
[529] *World Investment Report 1997, supra* note 44 at xxv.

not only attracting FDI, but also the efficient functioning of markets.[530] In a market based economy, the efficient functioning of markets depends on ensuring that firms are able to freely enter and exit the market and maintaining competition within those markets[531] In this respect, the entry of foreign firms into Venezuela's markets should help ease market concentration. The country's market has traditionally been characterized by high levels of concentration due to its small size and the long period of time in which domestic firms were sheltered from international competition.[532] In some cases, however, FDI liberalization may have the exact opposite effect upon a host country markets. Foreign affiliates can utilize their large ownership advantages (i.e. technology, management skills, trademarks, etc)[533] vis-à-vis domestic firms to establish a dominant position which can lead to the use of restrictive business practices.[534] Therefore, it is important for countries like Venezuela to ensure that FDI liberalization leads to greater competition in the marketplace and that liberalization does not mean that public barriers to investment are replaced by private barriers[535] In this respect, anti-trust policies are crucial in a liberal market setting.[536]

Venezuela's competition law dates back only to 1992.[537] The general objective of the law is to promote and protect free competition and economic liberty in the

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530 *Ibid.*
531 *Ibid.*
532 Jatar, *supra* note 24 at 3.
533 See in this regard *supra* note 53 and accompanying text.
534 *World Investment Report 1997, supra* note 44 at xxvii. Restrictive business practices are anti-competitive behavior by firms. MNEs engage in the same types of anti-competitive behavior as domestic firms: collusion among producers, monopolizing mergers and acquisitions, exclusionary vertical practices, and predatory behavior.
535 *World Investment Report 1999, supra* note 1 at 176.
536 Anti-trust policies are commonly defined "as the body of laws and regulations governing business practices (horizontal or vertical agreements between enterprises, abuses of dominant position, monopolization, mergers and acquisitions). See: De Leon, *supra* note 23 at 7.
537 *Ley Para Promover y Proteger el Ejercicio de la Libre Competencia,* Gaceta Oficial No. 34.880, January 13, 1992.

marketplace.[538] As a general rule, the law prohibits any conduct, practice, or agreement which interferes with competition in the marketplace.[539] The law specifically prohibits any action intended to impede the entry of new participants into the marketplace or to drive out existing competitors.[540] The law also prohibits restrictive vertical distribution agreements,[541] competition-restricting horizontal agreements[542] and the abuse of a dominant position in the marketplace.[543] Finally, the law does not prohibit mergers and acquisitions, but it does prohibit them when they restrict competition or when they produce a dominant position in the marketplace.[544]

The agency in charge of enforcing the law is the Superintendence for the Promotion and Protection of Free Competition (Superintendencia para la Promoción y Protección de la Libre Competencia).[545] This agency can on its own accord initiate an investigation when it considers that an infraction has occurred, or it may do so at the request of a private party.[546] In investigating any possible wrongdoings, the Superintendence has broad powers: it can summon individuals to testify or to present

[538] *Ibid.* Art 1. Article 3 of the law defines free competition as: "...that activity in which the conditions exist for any market participant, whether he act as a seller or a buyer, to freely enter or exit the market, and those already in it do not have the possibility individually or collectively to, impose any conditions upon transactions." The same article defines economic liberty as "the right every person has to dedicate himself to the economic activity of his choice without any other limitations than those derived from other people's rights or those established in the Constitution or other laws of the Republic." [own translation].
[539] *Ibid.* Art 5.
[540] *Ibid.* Art 6.
[541] *Ibid.* Art 7. See also Jatar, *supra* note 532 at 17. A restrictive vertical distribution agreement is any practice which limits or restricts the liberty of any of the two parties which have a vertical business relation, for example, a manufacturer forcing a supplier to receive only his products. In some cases, the competition authority can allow vertical agreements when it considers that it enhances efficiency.
[542] *Ibid.* Art 10. See also: Jatar, *Ibid.* Horizontal agreements are agreements between competitors in order to limit the competition.
[543] *Ibid.* Art 13. Among those practices which are considered to be an abuse of a dominant position in the marketplace are discriminatory pricing, an unjustified limitation of production, discrimination against certain producers or buyers, and the establishment restrictive clauses in contracts.
[544] *Ibid.* Art 11.
[545] *Ibid.* Art 19.
[546] *Ibid.* Art 32.

information, it can examine accounting records,[547] and it can even order temporary injunctions.[548] If an investigation shows that an infraction has occurred, the Superintendence has the power to order the suspension of the restrictive business practices and to eliminate its negative effects.[549] In addition, the Superintendence can impose fines ranging from 10 to 40% of the offender's yearly revenues.[550] The decisions of the Superintendence are final, and can only be overturned by a court of law.[551]

In general, we consider Venezuela's competition law to be rather complete. There is, however, one modification we would suggest, and that is that the Superintendence be given the power to screen important mergers and acquisitions (M&A's). As the law now stands, there is no previous control for these operations. In our opinion, a system of prior authorization of M&As would be useful since many of these operations depend on the stock value of the companies involved at a given point in time and are difficult to unscramble once they have been consummated.[552] In order to minimize administrative burdens, prior authorizations may be required only for M&As exceeding a certain amount.

To conclude, we must point out that the 1992 Competition Law covers restrictive business practices only at the national level. Restrictive business practices at the regional level are dealt through Decision 285[553] of the Andean Community (formerly known as

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[547] *Ibid.* Art 34.
[548] *Ibid.* Art 35.
[549] *Ibid.* Art 38. Para. 1.
[550] *Ibid.* Art 49. The severity of the fines depend on such factors as the method used to restrict competition and to what extent competition was restricted, by the restrictive practice, the duration of the conduct, the effect upon other competitors, and whether the person or firm has already committed a previous infraction. *Ibid.* Art 50.
[551] *Ibid.* Art 53.
[552] *World Investment Report 1997, supra* note 44 at xxx.
[553] *Decision 285*, (21 March 1991) http://www.comunidadandina.org/NORMATIVA/DEC/D285.HTM (date accessed: 30 March 1999) [hereinafter *Decision 285*].

ANCOM).[554] This Decision grants the General Secretariat of the Andean Community[555] the faculty to investigate and to take the necessary steps to eliminate any restrictive business practices within the regional market.[556]

2. Devaluate the Currency

Another cause of concern for developing countries is the impact FDI can have on their country's balance-of-payments. In the past, developing countries sought to minimize FDI's negative impact on a country's balance-of-payments by limiting a foreign investor's access to foreign exchange and by establishing profit repatriation ceilings.[557] Currently, however, most countries have abandoned these controls and are now trying to control foreign exchange outflows by establishing more flexible foreign exchange regimes.[558] A more flexible foreign exchange regime allows a country to make adjustments in its foreign exchange rates according to supply and demand. Therefore, when demand for foreign currency increases a country devaluates its currency, and vice-versa, when demand for foreign currency decreases a country appreciates its currency.[559]

If Venezuela is to limit FDI's negative impact on the country's balance-of-payments it will have to devalue its currency. Since the 1930s, the country's currency has been severely overvalued. The only time in which the country's currency approximated its real value was for a brief period during 1989 and 1990 when the

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[554] See also *supra* note 31 and accompanying text.
[555] On August 1, 1997, the Board of the Cartagena Agreement was replaced by the General Secretariat of the Andean Community. This is the executive body in the regional market. See: "General Secretariat of the Andean Community" (January 2000) http://www.comunidadandina.org/english/bodies/bodies_4.htm (date accessed: 12 February 2000).
[556] *Decision 285, supra* note 553. Art 16.
[557] See also *supra* note 218 and accompanying text.
[558] *Trade and Foreign Direct Investment, supra* note 50 at 24.
[559] *Ibid.*

government made constant efforts to keep exchanges rates according to inflation rates.[560] Since then, however, subsequent governments have continued to allow the national currency (the Bolivar – Bs) to exceed its fair market value. In the 1990s, inflation grew at a rate of 290% while the value of the Bolivar in relation to the U.S. dollar only fell 149%.[561] Although it may be popular for the government to maintain the value of the Bolivar in order to combat inflation problems, in the long run this measure hurts the country's competitiveness.[562] It means that all industries (both foreign and national) tend to import a greater number of their inputs from abroad rather than from domestic producers. A more appropriate way to fight inflation is through tight fiscal discipline and by controlling monetary circulation.[563] This does not mean, however, that the government should abruptly decrease the value of the country's currency. Instead, the government should gradually depreciate it in order to avoid severe inflation problems.

3. Reduce Transfer Pricing

Transfer pricing consists in manipulating the prices of transactions which take place within an MNE's network (between a parent firm and its affiliate or among affiliates) in order to lower their tax receipts.[564] This practice was particularly common during the 1970s and 80s when MNEs used this practice in order to circumvent host country restraints upon profit repatriations and high corporate tax rates in developing countries.[565] The incentive to use this practice has somewhat decreased now that the majority of developing countries have eliminated restrictions upon profit repatriations

[560] Francés, *supra* note 272 at 88.
[561] P. García, *El Universal* "Desaparecieron 36% de las Industrias" (9 April 2000) 2-1.
[562] Francés, *supra* note 272 at 87.
[563] *Ibid.* at 88.
[564] *World Investment Report 1999, supra* note 1 at 166.
[565] *Ibid.*

and have lowered corporate tax rates.[566] Despite these steps, however, MNEs will continue to use transfer pricing as long as it helps them maximize their profits.

The signing of double taxation treaties (DTTs) by Venezuela should go a long way towards reducing this problem.[567] DTTs, as their name implies, are designed to cut down on the incidence of double taxation. Double taxation occurs because of overlapping tax jurisdictions; in other words, two countries can claim tax jurisdiction either because the income-generating activity takes place in their territory or due to the residence of the taxpayer.[568] DTTs help to reduce the incentive to use transfer pricing by allowing an investor that pays tax in the host country to receive a credit against taxes in his home country, or to be exempted from paying taxes with respect to that income.[569] In addition, DTTs allow host countries to make adjustments in a company's income tax declaration when its suspects the use of transfer pricing.[570] The home country, if it accepts the adjustments made by the tax authorities in the host country, also has to make the corresponding adjustments in their tax receipts.[571]

DTTs , however, will not completely eliminate the problem of transfer pricing. In a recent survey conducted by UNCTAD, 84% of the developing countries surveyed

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[566] *Ibid.*
[567] *Ibid.* at 28. So far Venezuela has signed 13 of these treaties. See: D'Empaire Reyna Bermudez & Asociados, "Amendments to Venezuela's Income Tax Law" (24 November 1999) http://www.drbalegal.com/legal/loclislrespanol.htm (date accessed: 24 February 2000) at 2. In addition to the United States, Venezuela has signed DTTs with Germany, Belgium, France, Holland, Italy, Norway, Portugal, United Kingdom, Sweden, Switzerland, Czech Republic, and Trinidad and Tobago.
[568] *World Investment Report 1998, supra* note 43 at 75.
[569] *Ibid.* at 79.
[570] DTTs consider firms to be associated when: 1) a firm in a Contracting State has direct or indirect participation in the direction, control, or patrimony of a firm located in the other Contracting State; and 2) when the same persons participate directly or indirectly in the direction, control, or the patrimony of a firm in one Contracting State and another in the other Contracting State. See: *Ley Aprobatoria del Convenio entre el Gobierno de los Estados Unidos de América con el objeto de evitar la Doble Tributación y prevenir la Evasión Fiscal en Materia de Impuestos sobre la Renta y sobre el Patrimonio* (Double Taxation Treaty between the U.S. and Venezuela) Gaceta Oficial Extra No. 5427. January 5, 2000) Art 9(1).
[571] *Ibid.* Art 9(2).

considered that the affiliates in their countries were shifting taxable income to their parent companies.[572] This problem, however, is not only limited to developing countries. In 1994, the United States had to make adjustments of $3.5 billion to reported incomes due to the use of transfer pricing.[573] In the future, greater cooperation between countries will be necessary in this area.

4. Develop Local Enterprises

Finally, we come to an issue of critical importance to all developing countries, that is to say the development of local enterprises. In the past, Venezuela had basically taken the view that the development of domestic enterprises was better served by a strategy highly restrictive to FDI. However, this strategy which began with the implementation of Decision 24 and ended with Decision 291 did not produce the desired results. In the long run, domestic firms sheltered from international competition were not forced to innovate and eventually became highly inefficient.[574] Since 1991, however, the country has dropped most investment barriers and has pursued a strategy of greater insertion into the global economy.[575] One of the main objectives of this change in strategy is that domestic firms, through their interaction with foreign competitors, will acquire important skills and will be forced to improve their capabilities in order to remain competitive.[576] In this strategy, however, the role of government changes from one of protection of domestic firms to one of facilitating the transfer of technological skills from foreign firms to domestic firms.[577]

[572] *World Investment Report 1999, supra* note 1 at 167.
[573] *Ibid.*
[574] Ramirez, *supra* note 177 at 82.
[575] See in this regard *supra* note 24 at 2.
[576] *World Investment Report 1999, supra* note 1 at 220.
[577] See also in this regard *supra* note 101 and accompanying text.

Probably the most important step a government can do to accelerate such a transfer is to improve domestic skills. As UNCTAD points out: "[t]he higher the level of local capabilities and the more competitive the environment, the better the quality of the initial transfer and the more rapid its upgrading."[578] The most important thing governments can do to improve the capabilities of local firms is to provide them with a highly skilled labor force. As this point was discussed earlier,[579] we will only mention here that the country's education system should be able to provide businesses with highly qualified professionals geared towards the specific necessities of those firms.[580]

The other major step the government can take to improve the capabilities of domestic firms is to create publicly funded institutions to assist companies with their technological needs.[581] These institutions do not have to be geared towards producing cutting-edge technology, but initially towards producing some basic technology and assisting domestic firms in purchasing the best foreign technology, and allowing them to make the best use of that technology.[582] In some cases, these institutions may even be able to encourage foreign firms to perform some local research and development (R&D). There are some interesting examples in other developing countries in which local research institutions have established research contracts with foreign affiliates.[583] In Venezuela, however, there are currently few institutions that perform this type of work, and the ones that exist are generally rather small and poorly funded.[584] In order to improve this situation, the government will have to significantly increase the amount of

[578] *Ibid.* at 223.
[579] See also in this regard *supra* note 488 and accompanying text.
[580] See also in this regard *supra* note 498 and accompanying text.
[581] Francés, *supra* note 272 at 154.
[582] *Ibid.*
[583] *World Investment Report 1999, supra* note 1 at 213.
[584] Francés, *supra* note 272 at 155.

funds it currently dedicates to scientific and technological activities. In 1996, the government only dedicated 0.74% of its GDP on these activities; this is below the 1% recommended by international organizations like UNESCO.[585] Ideally, the country should aim at spending approximately 2% of its GDP on such activities.[586]

In addition, the government can also utilize performance requirements in order to promote closer linkages between foreign and domestic enterprises.[587] It important to remember, however, that the use of certain performance requirements has been banned under the WTO's TRIMs Agreement.[588] Nonetheless, this Agreement still allows developing countries to use other valuable performance requirements, like technology transfer requirements, or domestic ownership requirements. The use of these performance requirements may be particularly valuable in those areas in which Venezuela can build a comparative advantages. One such area is the petroleum-related service industry in which local firms are particularly competitive due to their continuous relationship with the national petroleum company (PDVSA).[589] However, these measures should only be taken after a careful evaluation has been done by the government of their economical feasibility, and if possible, after consultation with both domestic and foreign firms. The government may even create an agency to promote closer interaction between foreign and domestic firms.

To conclude, it is important to point out that a country's strategy to develop local enterprises will be constantly subject to modification. Although at the initial stages of

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[585] *Ibid.*
[586] *Ibid.*
[587] The Law to Promote and Protect Investment clearly establishes that the government can condition the receipt of an advantage or benefit by an investor to the fulfillment of certain performance requirements. See also in this regard *supra* note 324 and accompanying text.
[588] See also in this regard *supra* note 386 and accompanying text.
[589] Corrales, *supra* note 374 at 10.

development a country may rely heavily on FDI to acquire technology, at later stages of development a country may choose to restrict it.[590] The most important consideration in applying any measure is to ensure the competitiveness of local firms. As Venezuela's experience demonstrates, firms that are sheltered too long from competition, lose their incentive to innovate and eventually become inefficient.

[590] *World Investment Report 1999, supra* note 1 at 221.

V. Conclusion

For a quarter of a century, Venezuela stringently regulated FDI. Although one of the main objectives of this regulation was to minimize FDI's negative impact on the country's economic development, the tough conditions placed upon foreign investment eventually served to discourage investment in the country. During the 1970s, high oil prices and the availability of international bank loans meant that the country did not have to rely on equity capital for its development needs. In the 1980s, however, the situation dramatically changed due to a drop in oil prices and the refusal of international banks to continue lending to heavily indebted countries like Venezuela. The need to attract alternative sources of capital and the introduction of market-oriented reforms in the country finally led to the liberalization of FDI laws in Venezuela.

The liberalization of FDI laws, however, is just the initial step in attracting FDI inflows. In a global economy in which more countries are competing for FDI, those countries which are able to create the most favorable overall investment climate will be the ones able to attract the greatest FDI inflows. A country's investment climate is composed not only of a legal aspect, but also of such aspects as the quality of the country's infrastructure and human resources, political and economic stability, and the competitiveness of local firms and institutions. Although Venezuela has liberalized its investment laws, it still has a long way to go towards improving these other aspects of the country's investment climate.

In addition to improving the country's overall investment climate, Venezuela has to attempt to maximize FDI's contribution towards the country's economic development. In this respect, probably the most important thing the host government can do to accelerate the transfer of technology and skills to domestic firms is to improve the latter's capabilities. Improving the capabilities of domestic firms, however, requires that the country make substantial improvements in education and technological capabilities. In addition, the government can promote closer linkages between foreign firms and domestic firms through the use of performance requirements. However, these performance requirements have to be implemented in such a fashion that it does not affect the competitiveness of foreign firms.

With appropriate policies, there is no doubt that FDI can contribute to Venezuela's economic development. FDI, however, is not a panacea to all of the country's problems. In the end, FDI's contribution to the country's economic development will ultimately rest upon the development of domestic skills and capabilities.

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