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Although in the last few decades, we have witnessed the growth of an assortment of international agreements governing a variety of issues, the world remains primarily a community of nation-states, each with its own body of law, interests, and unique outlook. Even the European Union (EU) remains a collective of national sovereign states with their separate and unique national legal systems. This situation makes it valuable to begin the discussion of international business law with a review of the relationship between culture and law in such diverse nations and national groupings as the United States, Europe, Japan, the Islamic nations, the developing countries, and the socialist and newly independent states freed from the yoke of communism.

Even this awareness of diversity will unavoidably involve an oversimplification, since the world is considerably more complex than such groupings suggest. Within the United States there exists, for example, the federal government and 50 different state governments—all with separate legal systems. If this is true for the United States, it holds with even greater force for the national groupings just mentioned, since the nations that make them up are by no means alike.

In any analysis of law, there is also a natural division between "substantive issues" and "procedural issues." Some of the major areas of discussion in this chapter are primarily substantive, in that they deal with rules that actually govern international business conduct. It will be important, however, to remain aware of the many issues of process involving the mechanisms by which these rules are applied and by which parties seek a resolution of conflict. Even though the sections on national sovereignty, international legal issues, and multinational corporation operational disputes are largely substantive, procedural points will inescapably be intertwined with them, and it is worthwhile to pay attention to them as they arise.

It is indispensable for firms engaging in international business to seek competent legal advice in each area of concern and for each country. Nonlawyers, however, will benefit from a review of international business law as presented in this chapter by learning to recognize when to seek advice and by understanding the context to which the advice relates.[a]

Chapter Vignette

General Electric (GE) and Honeywell International Inc.

European countries used to be passive regarding antitrust regulations for mergers of large multinational corporations. In fact, they basically let the United States decide courses of actions instead of intervening directly. Lately, the European Commission, which is in charge of antitrust laws and their applications in the European Union (EU), has been more aggressive than ever in imposing antitrust regulations.

Originally, European antitrust laws were basically taken from the American regulations. Nevertheless, these laws have evolved and changed, reflecting European goals. American antitrust

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laws were put in place to protect customers. European regulations aim to guarantee for firms equality of business opportunities in the marketplace after a merger.

In June 2001, a 5-month negotiation between two U.S. firms, GE Company and Honeywell International, ended in collapse when the EU used its authority to disallow the pending acquisition.

There are a few explanations for the EU's action. First, what happens after a deal is approved if it does not promote competition? EU regulators do not have the luxury of legal enforcement to avoid market power abuses by merged companies. They do not have the means to restore competition. In the United States, however, litigious government entities or members of society have the right to file suits where opposition exists. The Europeans have a one-shot possibility to approve or block a merger. Once a merger has been approved, there is no turning back. This is an important reason why in making its decisions, the European Commission takes more time to investigate and puts more pressure on large mergers.

Second, unlike in the United States, in Europe, competitors to possible mergers have a considerably stronger voice. The U.S. rivals to a proposed merger seldom speak out directly against such acquisitions. They tend to focus on, and request, imposing strict limitations on mergers. In that way, they affect the outcomes.

The GE-Honeywell case shows different approaches. In the United States, a deal is approved if consumers will gain from lower prices and better purchasing conditions after a merger. Europe, on the other hand, justifies some protectionism to defend competitors as a way to guarantee competition. A concept of "bundling" has been developed in Europe. If a merger gives one company a broad range of products or business that would give it an advantage over rivals that have only limited products or lines of business, the merger would not be allowed. In the GE-Honeywell merger, for example, two different core businesses, jet engines and avionics, would be detrimental to European Rolls-Royce, an engine supplier. Europeans argue that in the short run, this kind of merger might benefit consumers, but long-run benefits should also be measured to ensure that harm on rival firms would not hurt competition.[1–3]

Introduction

The GE and Honeywell vignette illustrates a few legal issues pertinent to international business. First, it shows how the law of international business often involves commonplace issues. It undercuts the natural but usually naive assumption that international legal issues, simply by being "international," are necessarily larger than life. Second, it demonstrates how the law of other countries can be a controlling factor on issues far away from the individual national markets. Third, the case points to the extraterritorial nature of some national laws that can affect international business. Fourth, on the very same issue, national laws can be in direct opposition to the national interests of other countries. Finally, it is worth noting that there is no special tribunal available to nongovernmental entities for resolving this kind of dispute. In the absence of a globally recognized dispute settlement, the verdicts of the courts of the "host country" remain in effect. International tribunals exist for some purposes; for example, disputes arising from international treaties can be taken to the World Court. But most of

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the world's legal business is done by the standard courts and administrative agencies of the country exercising jurisdiction.

Cultural Heritage and Business Law

The international scene, in its effect on law, involves a mixture of diversity, born out of widely varied cultural heritages and circumstances, with certain unifying themes. The sections that follow illustrate the diversity by specific reference to certain nations and regions. More generally, however, it should be noted that countries differ widely on many aspects of law and over a vast range of issues. Some have gone quite far in the area of environmental protection, while others impose relatively few constraints. Some are strongly in favor of market competition, vigorously enforcing their antitrust laws, while others favor large-scale, protected industries. Some have extensive social and labor legislation, such as that passed in the United States dealing with employee layoffs and plant closings, while others do not.

Many reasons exist for these differences. To illustrate, consider the varied approaches to intellectual property (IP) rights. IPs represent one major form of property, the rights to which govern exclusive use of an intellectual contribution such as an invention or a work of art. The principal reason for differences in the way IPs are treated lies in the fact that developed and developing nations often perceive their interests in diametrically opposite ways. The developed nations, with their preference for economic dynamism, emphasize the importance of protecting inventors through strong patent, trademark, and copyright coverage. This is to encourage the constant improvement of technology. If IPs are given weak protection in many parts of the world, the developed countries see this as a major loss of compensation and, hence, of incentive to creative persons and firms. Certainly, this view is taken by the industrialized nations, especially the United States, which has been the world's leading supplier of technology since World War II. As developing countries advance economically, they begin to share the same perspective. This has been the case with several countries such as Korea, Mexico, and Turkey, which are rapidly industrializing and whose perspective is accordingly beginning to match that of the technologically advanced nations. In contrast, many of the poorer nations give little protection to IPs, with the result that piracy in the form of unauthorized copying and imitation runs rampant. Technically, these are not acts of piracy in countries where a patent holder has not attempted to protect a patent. The problem is in gray market goods, where the goods are legally produced in a third country—where patent protection has not been established—but sent into a country where there is protection. This difference has shown up starkly in the varied protections given to computer software. The intention of governments in the less developed countries is to benefit their own peoples, but the failure to protect IPs sometimes produces tragic results. This is apparent when those nations

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give little patent protection to pharmaceutical inventions, which leads to diminished R&D on, or supply of drugs against, tropical diseases by large pharmaceutical firms.

Even in the face of differences, however, certain unifying themes bind the international community together. Legal systems can be classified into "legal families," since the nations in each "family" share a common legal heritage. One of these families stems from the Romano-Germanic Civil Law System, which has a long tradition of codification—that is, of formulating law in extensive written codes. A subfamily of these nations bases its law on the Napoleonic Code, the French Civil Code of 1804. These include countries as diverse as Poland, Indonesia, and the countries of equatorial Africa. Another subfamily, which not only includes several continental European countries but also encompasses Japan and South Korea, bases its law on the German Civil Code of 1896.

A second legal family stems from the Anglo-American common law system. Here, the law was developed primarily through a gradual accretion of court decisions, built up over centuries by courts' reference to earlier precedents. A separate system of procedures and remedies known as equity was developed by a parallel set of courts. But in the 19th century, "law" and "equity" were merged into a common system in most American states and in England. The vast influence of the Anglo-American system reflects the worldwide extent of the British Commonwealth, since this family includes India, Australia, Canada, and New Zealand, among others, and the dominant influence of the U.S. systems.

The increasing role played in world affairs by Islamic nations makes it important to note the influence of Islamic law, based largely on the moral precepts laid down by Prophet Muhammad. This prevails in a large number of countries located primarily in the Middle East and southern Asia. Islamic law was frozen in content in the 13th century, and this rigidity leads to a rupture between Islamic fundamentalists, who wish to keep it as it is, and others who want to adapt it to the more secular modern world. The argument over law is merely part of the larger split among Muslims over the nature of Islam itself. The importance of Islamic law can be seen in the fact that one fifth of the earth's population embraces Islam. (For an extended discussion of the "legal families" that have formed world law, see Ref. 4, pp. 44–52; Ref. 5.)

In addition to the links forged among the legal families, ties are established through the elaborate mechanisms of international cooperation, such as conventions. A convention is an agreement, originated by an international organization, between two or more countries. This is illustrated in the area of transportation: The International Convention Concerning Carriage of Goods by Rail (CIM) applies to railroading, the Warsaw Convention spells out the extent of international airlines' liability, and the Hague Rules define the liability exposure of international water carriers. Another example is the Convention on Contracts for the International Sale of Goods (CISG), drafted through the collaboration of eight different international organizations and 62 countries.

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Efforts have been made to bridge the gaps that separate nations. For example, the North American Free Trade Agreement (NAFTA) among the United States, Canada, and Mexico was approved by the U.S. Congress in 1994. In addition, since 1947 successive rounds of negotiations about tariffs and other trade barriers have been conducted under the General Agreement on Tariffs and Trade (GATT). Recently, GATT provided a base for establishing the World Trade Organization (WTO). The WTO was discussed in a previous chapter. The WTO has enforcement power over judgments it renders on international trade disputes. The agreement arising from the Uruguay Round received Congressional approval in the United States within months of the approval of NAFTA. A major development has been the extension, among many nations, of most-favored-nation status, which spreads the reduction of barriers equally to participating nations. The developed nations have gone beyond this to create a system of preferences for developing nations.

The heritage of different cultures bears strongly on the business law of individual countries, as we see in the sections that follow.

The United States

Law in the United States has primarily grown up through court decisions, reflecting its British origin. On issues of federal constitutional and statutory interpretation, the federal courts have developed a body of decisions. On issues of state law, both the state and the federal courts apply the precedents built up by the courts of the state that is governed by the law. The separate court systems for law and equity were consolidated into a single system in virtually all states after New York took the lead in 1848. England followed in 1873. Later sections of this chapter explore several aspects of American law, but some are especially worth mentioning in this preliminary discussion of cultural differences.

Although practical and political considerations unquestionably play a frequent role, weakening any generalization, it is worth noting about American policy that idealistic considerations have often been a driving force. An example is the effort to ensure the integrity of business practices regardless of the location in which they are practiced. With the Foreign Corrupt Practices Act of 1977, the United States made it a criminal violation for any American company to bribe foreign governmental officials or political candidates. The legislation followed revelations that many American companies had given bribes. To ensure compliance, large companies were required to maintain certain accounting systems and have internal accounting controls that will give reasonable assurance that a company's representatives actually comply with the law and with company policy.

This idealism is not without cost. During the years since the act's passage, concern has been voiced by the business community that the law has had a chilling effect on the ability of American firms to compete in countries where

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bribery is rampant. (The concern over the anticompetitive impact of the Foreign Corrupt Practices Act is expressed, for example, in Ref. 4, p. 189.) This concern, fed by the decline in the United States' competitive position, led Congress to amend the statute in 1988 to limit its scope and to make it clear that only intentional, not inadvertent, violations would be subject to prosecution.

The same idealism can be seen in the strong U.S. policy against insider trading. Such trading involves the buying and selling of securities by someone who has significant information about a company that is not known to the general public. The federal Securities and Exchange Act of 1934 prohibits insider trading. In the early 1980s, after the Supreme Court interpreted the Act narrowly, Congress went so far as to strengthen it to ensure its wider application. This reflects a prevailing view in Congress that such trading takes advantage of a less-than-level playing field, subjecting the average investor to an unfair disadvantage.

Subject to significant exceptions, such as the Smoot-Hawley Tariff, which played so major a role in deepening the worldwide depression of the 1930s, the United States has been during much of the 20th century a stalwart proponent of a legally assured competitive market. This has led to two primary results: an antitrust policy that is stricter than those of many other nations and a commitment to free trade through lower tariffs and fewer barriers to commerce. This procompetitive stance reflects the powerful influence in American history of the promarket philosophy of classical and neoclassical economics. European economic integration, however, has narrowed the differences among corporate merger cases across the Atlantic. Also, in some cases, the European courts have applied much different and stricter criteria regarding corporate mergers.[2]

During the 20th century, American business law has seen a strong movement toward uniformity, and more flexibility, by reducing the complexity that can arise if 50 different states enact separate rules. The Uniform Commercial Code (UCC) has been enacted in all states except Louisiana since the late 1950s, and it codifies rules relating to the sale of goods, negotiable instruments, stock transfers, and other commercial subjects. For the most part, the rules are more flexible than earlier law, allowing the parties more alternatives than they previously had in a number of situations. For example, if a buyer unknowingly accepts defective goods, the acceptance can now be revoked under certain circumstances.

Europe

The law of continental Europe is based on the two major systems of codification, French and German, promulgated in the 19th century. The assumptions behind each code were fundamentally the same: private property, free-market economics, and individual self-sufficiency. European history during the 19th and 20th centuries has, however, involved massive

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challenges to the classical liberal model on which these assumptions were based, through both nationalist and socialist critiques hostile to it. Since law reflects the enormous complexity of history and thought in a society, it is not surprising that European legal systems today involve a significant mixture of ideologies.

Grave Frustration

Dr. Su Xian, a 36-year-old anesthesiologist, migrated from China to the United States of America and established a gravestone outfit called Sinostone, Inc., in Elberton, Georgia. Her presence in Elberton is a sign that globalization has arrived in the American monument industry. She came to Elberton simply because hundreds of buyers and monument dealers meet in this city each week. A seam of rock, 6 miles wide and 35 miles long, runs underneath Elberton, which has established its position as the tombstone capital of the United States.

Despite its added transportation costs, however, the Chinese monument importer undersells its local competitors. Unlike other gravestone manufacturers, Sinostone imports gravestones directly from China at a lower production price. The tombstones are all finished, lacking only names and dates.

Many in other industries have tried to slow the process of globalization through the use of legal and procedural schemes. Su's experience is no exception. So far, she has encountered a few problems. The Granite Association, for example, declined her request to become a member; according to the association, it had "no classification" for her business. The president of the Old South Granite Co. paid her a visit. He criticized Sinostone's prices and claimed that her monuments were dyed and not genuine granite. The head of the Elberton Granite Association requested that Dr. Su provide "chemical proof" that her gravestones are granite.[6]

This complexity has most recently been expressed by two diametrically opposed tendencies: one toward European unification and another toward resurgent nationalism. The latter became evident in the 1990s civil war among the Serbian, Croatian, and Muslim ethnic groups within the former Yugoslavia and in the protests within Germany against widespread immigration. However, despite the centrifugal tendencies of nationalism, Western Europe has since World War II engaged in a gradual process of unification, with the prospect of an eventual "One Europe." The Common Market, also called the **European Economic Community** (**EEC**) or simply the **European Community** (EC), was formed through the **Treaty of Rome** in 1957. It purposed to eliminate tariffs

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and trade barriers among its member nations, unify the currency (which it did in 2001), bring about the free movement of people and investment, and stand united vis-à-vis the rest of the world. The successor to the EC is the **European Union** (**EU**). With the elimination of virtually all barriers among the member nations, the EU has achieved most of these objectives. Also, it has expanded membership to include most Eastern European countries and eventually may include **Turkey**.

This new freedom of movement will be tested against ancient constraints. In Germany, for example, participation in business has traditionally required either membership in or some entrance into the society of merchants known as the "Handelskammer." In agriculture, several countries have a long tradition of protecting the small farmer. It remains to be seen how commercial freedom will work itself out within these contexts.

On the path to complete unification, the EU is facing many political, economic, and legal challenges. The inclusion of Eastern European countries has magnified these challenges. It seems, however, that legal accomplishments may precede, and smooth the way for, complete unification.

> When culture, history, language and even politics still divide member states, law has emerged as a holistic binding agent. Working behind the scenes, and cooperating in numerous ways, the EU's judges and lawyers are bringing communities together by applying similar standards and precedents.
>
> . . . European law—the element that all have in common—will gradually dominate the different national laws.[7]

Japan

The history of Japan has been marked by relative isolation, cultural cohesion, a high level of energy, nationalism, and a drive toward technological advancement. These factors are reflected even in so simple a thing as contract negotiation, where dignity, harmony, and social cohesion create an expectation for patient negotiation, long-term relationships, and few written formalities.

Conflict Resolution in Japan

It is a common understanding in Japan that, except perhaps within the world of big business, it is, as Singer[8] asserts, "almost indecent to go to court. If a marriage is to be dissolved, an employee dismissed, an agreement interpreted, the proper way is to have a 'talk' and, if this is unsuccessful, to accept mediation by a go-between or a mutual friend.

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A settlement, in order to be found satisfactory, has to take into account more than the rights and duties stipulated in contract. The whole situation of all parties concerned has to be considered—the former relations between the litigants, their relative wealth or poverty, power and social standing, and above all the peace of the community of which they are members. Law has not yet emerged from the stream of common life as a sphere of its own, opposing to the fluidity and many-sidedness of common life an abstract form, rational, hard and lucid like a crystal, objective and implacable. Between law and custom, habit and convention, order of nature and order of reason, natural inclination and social duty, no rigid demarcation lines are drawn. Everything remains contingent on circumstances, subject to swift transition" (pp. 71–72). (According to Magoroh Maruyama, the famous and prolific Japanese scholar, Singer's description is accurate and applicable in today's Japan.)

Disputes are seldom litigated, and there are relatively few attorneys. Sellers are almost never sued for injuries caused by goods. Japanese family life is characterized by low consumption and high rates of saving but a genuine desire for foreign goods. (For a discussion of how contract negotiations in Japan are affected by cultural influences, see Ref. 9, pp. 121–123.)

The cohesion is illustrated further by the interlocking directorates and links among Japanese firms, called Keiretsu. No parent company controls the approximately 40 companies that make up the Mitsubishi Group. Instead, each company owns part of the others, and direction is given by a "triumvirate" composed of the three leading companies. Top management from 26 companies meet at the Kinyo-Kai ("Friday Conference") (p. 159).[4] This cohesion makes new entry by competitors extremely difficult. There is a general acceptance of insider trading. Sogoshosha and Keiretsu structures, discussed in other chapters, are outstanding manifestations of those characteristics.

The government plays a major role. When a Japanese firm wants to license technology from a foreign licensor, it does so through a central licensing agency, which gives it substantially greater bargaining power than it would have if it negotiated the license itself.

Islam

The Islamic legal doctrine, or "Shari'a," prevails in several countries where there is a predominant Muslim population, such as some countries in northern Africa, the Middle East, and southern Asia. Countervailing tendencies

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exist between traditionalism and secularism, which affects participation in a worldwide commercial system. Secular influences have in recent years led many Persian Gulf countries to enact commercial codes. But even where such codes exist, cultural-religious traditionalism affects virtually all aspects of life. Nonmarket values rank high. In Pakistan, for example, an Islamic court banned the charging or payment of interest; the concept of *riba* bars unearned or unjustified profits; and that of *gharar* considers it gambling to make any profit that was not clearly spelled out when a contract was entered into (pp. 47–48).[9] Not merely the economic system, but the entire social system is molded by a nonsecular value system. For example, in Saudi Arabia women are barred from driving cars, and in other Muslim countries drinking alcoholic beverages is prohibited.

The Islamic religion considers interest payment or receipt as usury. It is called *riba* and is prohibited in any form. Today's business transactions, however, cannot be carried out without the use of loans. As a necessity, Islamic banks have emerged. The establishment and expansion of Islamic banks in Muslim and non-Muslim countries and particularly their growth in the member states of the Organization of Petroleum Exporting Countries (OPEC) have attracted the attention of the business community. These banks provide a full spectrum of financial services. They make loans, accept deposits, and offer fee-based retail banking services that do not involve interest payments. These services include letters of credit and guarantee, domestic and international money transfer, traveler's checks, spot foreign exchanges, investment management, mortgages, and other services. Certain adjustments have been made to match the religious requirements with the imperatives of the modern economic system. Take the case of interest payment, which is forbidden in Islam.

How can a bank operate without the use of interest? The answer is a profit- or loss-sharing system.[10–13] This should not be confused with a whole host of legal fictions devised by some financial institutions to avoid calling charges interest or *riba*. One such scheme calls interest a service charge. In a profit- or loss-sharing system, instead of guaranteeing a fixed rate of return (interest), the lender and the borrower enter into an agreement that spells out how profits or losses from the venture are to be shared between them. Therefore, in Islamic finance and banking, risk is shared by the lender, who then is encouraged to finance sound and secure ventures and avoid speculative ones. In this way, the joint ownership stakes encourage both the financier and the borrower-entrepreneur to engage in productive investments. The following example illustrates the mechanics of financing a mortgage.

Aghaa Noor-ud-Din and his wife Khorshid want to buy a house that costs $200,000. Aghaa Noor enters into an agreement with the Muslim Banking and Finance Corporation (MBF) for joint ownership of the house and puts down $40,000, or 20% of the principal. MBF finances the remaining $160,000 and leases its portion of the house to him. Aghaa Noor becomes the resident owner and pays rent based on the portion of the house that MBF owns plus a little more to increase his equity. The value of the

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house could be reassessed by the bank every year and rental payments adjusted accordingly. If the market value of the property has increased, the rent will increase and the amount Aghaa Noor must pay to obtain full ownership of the house increases. If the value of the house falls, so does the rent, which reduces MBF's income. In case of loan default, unlike in the conventional mortgage, Aghaa Noor does not lose his equity. MBF and Aghaa Noor split the proceeds from the sale of the property proportionately to their equity, with the result that if the value of the house has fallen to, say, $100,000, Aghaa Noor will still get back 20% of that sum, and the bank will therefore fail to recover its loan in full.

According to Islamic scholars, the essence of Islamic banking—namely, risk sharing or venture capital equity investment—is the most modern concept in finance. They assert that the United States, although not a Muslim country, in spirit and in real terms, offers more financing and investment along Islamic lines than all the Muslim countries combined. They point out that the phenomenal growth of Silicon Valley in California was in part fueled by billions of dollars in venture capital, a pure form of profit or loss sharing. Such well-known firms as Intel, Microsoft, Sun Microsystems, and Oracle were financed by the venture capital industry.[14]

Developing Countries

The underdeveloped countries, categorized with varying degrees of optimism as the "developing nations," have long been caught in the tension between needing industrial and technological growth to provide for their rapidly expanding populations and at the same time distrusting and resenting outsiders and market processes. Although these nations are participating to some degree in a worldwide move toward the privatization of enterprise, the main pattern has been central state control over societies that are often so diverse internally as to be only superficially governable.

Policies on most issues are formed out of a perception of national need. Since this need may be considerably at odds with what it takes to make a venture profitable, the policies can be self-defeating, except as judged by noneconomic criteria. To promote internal development, requirements are often placed on foreign investment, such as mandates to hire local managers, train native workers, reinvest profits, and build public utilities. Government policy is determined by a central development plan, together with what is often an intricate web of bureaucracy. In Brazil, for example, it takes an estimated 1,470 legal acts to obtain an export license (p. 482).[9]

Before an import license arrangement can be entered into with a firm in India, approval must be obtained from every government agency that will have anything to do with the product. Many requirements can seriously affect the commercial viability of the venture, such as the one that an Indian licensee must be free to export what it makes. This threatens the licensor with the possibility of "reexport," through which its own licensee becomes

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a competitor in the licensor's home market or in markets elsewhere around the world (p. 439).[9] In recent years, however, the fall of global communism and the failure of the command and control economic model have prompted India and many developing countries to reconsider their policies in dealing with multinational companies (MNCs).

Most developing nations place strict limits on foreign ownership and passive investments and impose restrictions on the payment of hard-currency royalties to foreigners. As noted previously, because they view innovation from their own standpoint, many of the nations believe that technology either is or should be a free good, and so they encourage, or at least do not take measures against, industrial piracy.

Attitudes and policies become more open to international trade as a nation approaches the threshold of technical development. Until recently, Mexico fit the general pattern, but in early 1990 it went from being virtually closed to technology transfer agreements to being highly receptive. Mexico's participation in NAFTA is accelerating this liberalization.

Socialist and Formerly Socialist Economies

Partly because of their relative lack of development and partly because of their ideological insistence on central governmental control, the socialist nations have had several characteristics in common with less developed countries. For example, any foreign ownership of a productive enterprise, in whole or in part, was generally prohibited. Of course, there are exceptions, such as China, which have permitted foreign corporations to share ownership of businesses with an agency of the government (p. 1276).[15] While these countries either have abandoned or are abandoning their socialist-communist past and are constructing market-based institutions, many of their practices remain basically the same. During the communist reign, all citizens, for example, were required to carry with them internal passports (permission to travel outside one's city of residence) at all times. This still is in practice in some former communist countries.

Business Contracts in China

The vast market of China is very attractive to MNCs. The potential profits are large, but so are the risks, including unresolved contract disputes. If a dispute arises, the first option—and the practical one—is to resolve it informally, by using friendly relationships that you should have established with your Chinese partner. Taking your dispute to the courts is not the best choice, because in China the rule of the law is a tenuous concept,

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and the legal process is very slow. Moreover, the existing, outdated laws are no match for the changing business environment of China.

Chinese are not as legalistic and litigious as Americans. The number of Chinese lawyers is a fraction of the number of U.S. lawyers even though the Chinese population is many times larger. If you start your negotiations using lawyers, you may give the impression that you do not trust your partners. The advice to newcomers to China is to be patient, to take their time, and to develop personal relationships with their Chinese partners. Once a trusting relationship is established, bargain hard, and put the agreement in a contract. However, before signing it, consult a lawyer. While the courts may not be the best choice for enforcing contracts and hearing disputes, nonetheless there do exist opportunities for legal recourse. An increasingly popular option is arbitration in the China International Economic and Trade Arbitration Commission. Through the Commission, parties in a dispute choose a panel to hear their case. Foreigners are allowed to sit on the panel.

Within the former communist countries, the transition to a market economy offers both opportunities and dangers. Currency problems, inflation, the crumbling of the infrastructure, a lack of experienced managerial or entrepreneurial talent, breakdowns in supply, confused political and legal relationships, and potential civil disorder, including even potential civil war, must all be gauged by the firms that enter the field. One of the great transitions in history is under way, if it can be made successfully; but it is a difficult time for firms and individuals.

National Sovereignty

With the League of Nations and later the United Nations, the world has in the 20th century made tentative approaches toward world governance. A large number of treaties and conventions bind nations to a common policy on a multitude of subjects. Nevertheless, national sovereignty continues as the central fact on the world scene. This section explores the varied manifestations of this sovereignty in the areas of taxation, currency exchange controls, trade restrictions, government takeover of industry, and privatization.

Taxes

There are many forms of taxation. Much of the discussion here is about income taxation, but it is worth noting that value-added taxes, or VATs

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(a form of sales tax imposed at each level of production and distribution), have become common. In recent years, the political situation within the United States has been particularly volatile with regard to a willingness to consider differing forms of taxation, such as a flat tax on income or a removal of all taxation on capital gains.

Several small nations such as Bermuda, the Bahamas, and the Cayman Islands have made themselves tax havens by having no income tax. Others provide incentives such as tax credits, tax holidays, and favorable rates. Switzerland has long made itself a favorite by protecting the confidentiality of bank accounts (this was begun in the 1930s to shield the identity of Jewish depositors from inquiries by Nazi Germany). Since World War II, these havens have attracted a large volume of business activity. To combat this, several countries have copied the anti-tax-haven provisions, called Subpart F, of the United States' Internal Revenue Code, which applies the idea of "deemed income," imputing income to investors even though they have not received a distribution of the income from a business firm. Moreover, even where incentives are offered, business firms must scrutinize tax incentives carefully for pitfalls: Lebanon, for example, has required that if a firm receives tax benefits for 5 years, it must stay to conduct business for an equal period, a commitment that many firms would be wary to make in any event, much less under the strife-ridden circumstances in Lebanon not long ago.[16]

To reduce their taxes, some U.S. companies relocate their headquarters offshore and transfer patents, trademarks, and other intangible assets to their subsidiaries abroad. To prevent these and other corporate-accounting abuses, U.S. Treasury and Internal Revenue Service are considering various options, including prohibiting them from doing business with various federal agencies.[17]

Countries differ in whom and what they tax. Three main systems are used (for a detailed discussion of the varied systems of taxation, see Ref. 4, pp. 688–697):

1. To tax citizens or nationals of the country on all their income, no matter where they made it and without regard to where they have their residence ("nationality principle")
2. To tax legal residents within the country, regardless of where they earned the income ("residency principle"; the 66 countries that use this system also tax all income generated within their borders, even by people who are living in other countries)
3. To tax any income earned from activities within the taxing country but not income earned elsewhere ("source principle"; nationality and residency are considered for some purposes; the source principle is used by more countries than any other)

All this raises, of course, a considerable possibility of multiple taxation of the same income. The nations of the world have grappled with this in a number of ways. (The methods of handling the problem of multiple taxation

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are discussed in Ref. 4, pp. 704–708.) One way is for the home nation not to tax income that has been taxed by the host country (the exemption system). A second applies a tax credit, reducing the tax in one country by the amount paid in another (the credit system). A third does not give a credit, which reduces the tax dollar for dollar, but only a deduction, which reduces the declarable income (the deduction system). From the point of view of the taxpayer, the best is the exemption system, the worst the deduction system. The credit system results in the taxpayer paying whichever is the higher rate between the two nations.

Tax strategy is accordingly important to those doing business internationally. In this context, the type of business entity (i.e., partnership, corporation, etc.) used is important, since tax treatment typically varies as to the different business forms, just as it does in the United States. A pitfall is that the host country may not treat the entity as being what it appears. Many have a central registrar that categorizes the firm in terms of local law (p. 676).[4]

Most countries' income tax systems, like that of the United States, have a graduated scale of rates. But some countries, such as Jamaica and Iceland, impose a flat rate on personal income. Almost two thirds of the world uses a flat rate in taxing corporate income, varying the rate from industry to industry. A danger in less developed countries is that the government may impute a profit to a company and then tax it if the government believes that the company did not report a reasonable profit (pp. 699–700).[4]

The impact of globalization on taxes should be acknowledged. As a factor in globalization, capital and labor mobility undermine the ability of nations to set their own level of taxes. The Internet has further eroded their autonomy. In response and to preserve their sovereignty, increasingly governments will have to set multilateral rules. Only this line of action enables them to reclaim the control over national affairs that has been lost to globalization.[18]

Currency Exchange Controls

Unless the parties use barter (an exchange of goods or services for other goods or services), payment under a contract will be in the currency of some agreed-on nation. This raises two questions. First, is the currency convertible? Second, can the funds (profits) be repatriated?

The world monetary and banking system consists of a marketplace with a number of firms rather than a single comprehensive structure. People speak of a foreign exchange market, but it is not to be found in any one location because the market exists in reality in the millions of transactions conducted around the globe by a great many banks, brokers, and dealers. Custom plays a large role, as does each country's own laws and institutions, along with such world agencies as the International Monetary Fund and the Bank for International Settlements. Many of the relationships are governed by informal agreements.

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A currency is considered convertible if, within this market, it can be traded freely for others at the ratios established by the market. This is done through either spot or futures contracts. Most convertibility is done on a spot basis, where money is exchanged for another currency that will be delivered to the buyer within 2 business days. A futures contract provides for a later delivery of money, normally within 30, 60, or 90 days. By locking in the exchange rate at the time the purchase is made, the buyer of the currency is able to hedge against the risk of future rate changes.

Problems exist in repatriating profits from a number of developing countries, which may require permission, place a percentage restriction on the amount that can be taken out, or specially tax such profits. If a foreign business liquidates its assets, any amount it receives over the firm's initial investment may be considered as dividend and treated accordingly. These difficulties point to the dangers of short-term investment in developing countries.

In the United States, the Overseas Private Investment Corporation (OPIC) sells insurance that applies where there is a legally existing right of convertibility. If the insured is confronted by a foreign government's denial of that right, or if conditions (such as banking procedures) change to block convertibility, OPIC will make it good. OPIC coverage is not available, however, for dealings with countries that grant no legal right to convert. (For a more complete discussion of OPIC, see Ref. 4, pp. 83–88.)

Trade Restrictions: Tariffs and Quotas

The impact of issues relating to national sovereignty on trade restrictions is well illustrated by the history of the United States. The United States was committed to free trade during the Jefferson-Jacksonian era prior to the Civil War but was heavily protectionist under the leadership of the Republican Party from the Civil War until the 1930s. The worldwide depression during the 1930s provoked a clamor within each nation to withdraw from world trade as a way to "save itself." But as the world emerged from World War II, this was generally perceived as having prolonged and deepened the depression. This perception has led to continuing efforts since World War II to negotiate a removal of trade barriers. At present, the situation is characterized by movement away from both trade restrictions and governmental intervention into expanded free trade.

Governmental intervention in trade comes in many forms, including tariffs and other constraints on imports, export controls, state subsidies, limits on foreign investment, preferences in government procurement, and countermeasures against "dumping."

Imports. As for the United States, the laws relating to imports are almost all at the federal level because under the Constitution the states have virtually nothing to do with foreign commerce. Under the "import-export clause" of

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the Constitution, a state cannot tax an import. The U.S. Supreme Court has accordingly been called on at various times historically to establish tests for the point at which a good loses its character as an "import" and starts being just part of the mass of property that is subject to property taxes.

Some imports are prohibited. These include such things as illegal drugs, food that is considered dangerous, and obscene or insurrectionary published materials. Sometimes the prohibition is imposed not because the item is harmful but to protect a certain industry. At other times, the prohibition is retaliatory, such as the U.S. ban on fish from a country that seizes American fishing boats. Since 1917, the U.S. "Trading With the Enemy Act" has barred imports from countries engaged in armed conflict with the United States. Quotas are sometimes imposed on imports and are less severe than outright prohibitions. The "voluntary" restrictions that a decade ago Japan had placed on its automobile exports to the United States were a substitute for the quotas that the United States had once imposed.

A tariff is an ad valorem tax, since it is based on the value of the import. Whether a tariff will apply depends on where the goods came from, how they are classified, and what value is given to them. Various practical aspects, such as the rate to be used and whether any trade restrictions apply, depend on the country of origin. If more than one country has been involved in the creation and transport of the goods, rules of origin are used to determine which is the country of origin. The main rule is the "substantial transformation test," which looks to see where the product underwent a major change. (A discussion of the country-of-origin rules appears in Ref. 9, pp. 352–359.)

Although procedures vary from country to country, it is helpful to understand the steps in the U.S. entry process (discussed at length in Ref. 9, pp. 332–340). The importer posts a bond to guarantee that the duty will be paid. Entry documents, with a complete commercial invoice telling about the shipment, are processed by the U.S. Customs Service, and the tariff is entered on an entry summary form. The importer is allowed to have the goods after a tentative duty is set. The final ruling by the Customs Service about the tariff, which by law must be made within 1 year of the goods' entry, is called liquidation. There is a right to appeal at the administrative level and then in court. If the importer wants to know ahead of time whether there will be a duty, the firm can ask for a binding ruling.

Exports. In the United States, the Constitution prohibits a tax on exports, which makes their treatment substantially different from imports. All the same, the federal government has traditionally controlled exports. A rule of thumb is that it takes permission by way of an export license to send anything out of the country.

Some exports are prohibited ("embargoed"). The reasons include ensuring the availability of goods that exist only in a small quantity, prevention of nuclear proliferation, and other foreign policy and national security goals. The United States and 16 other nations belong to the Coordinating

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Committee for Multilateral Export Controls (COCOM). Violation of its constraints, such as that against selling certain types of military technology to unfriendly nations, is a criminal offense. Such a prohibition arose with regard to Iraq after its seizure of Kuwait, and exports are banned from regimes such as those of Cuba and North Korea, which remain committed to communism, or countries that are considered to support international terrorism, such as Libya. To know what is currently prohibited, an exporter should check with the Office of Export Administration, which carries out the Export Administration Act, to see what is on the "commodity control list." Other agencies can also play a role, such as the Nuclear Regulatory Commission for the export licensing of nuclear materials and the State Department for military hardware.

Because it would be easy to circumvent these prohibitions by sending the goods to an acceptable destination with the intent that they then be sent on to one of the prohibited destinations, an end-user certification is required. American law makes the exporter accountable for where the product is finally used, such as North Korea, even if the goods are sent to that location by someone else after the exporter has gotten them to a valid destination such as France (pp. 160–161).[16]

Most exports don't involve prohibited destinations. For exports in general, two kinds of licenses are issued. A general license is a blanket approval for the export of goods of a certain kind and can be issued by the exporter to itself if it complies with certain rules. A validated license is governmentally issued, looks to the nature of the goods and where they will ultimately be used, and is specific to a certain transaction (p. 160).[16]

Nontariff Trade Barriers. Governments have seemingly endless ways to restrict trade. Some of them are framed, with varying degrees of plausibility, in terms of health, safety, or environmental protection. They include the following (see Table 7.1):

- *Embargoes*: As noted, embargoes can apply to imports, exports, or both.
- *Quotas*: Again as noted, quotas limit rather than prohibit.
- *Currency controls*.
- *The imposition of unique performance, environmental, health, or safety specifications that a foreign firm may not be prepared to meet*: A commonly cited example is the EU's ban on American beef because U.S. ranchers use growth hormones.
- *Preferential treatment given to the country's own suppliers when the government is procuring supplies for its own use*: This is common in the major industrial nations. At least with regard to expensive items, there has been an effort through the Agreement on Government Procurement to limit such preferences (pp. 347–348).[4] Most military production falls into this category. Globalization, however, has even altered the nature of business in arms production. Recently, for example, the U.S. government and defense industry officials convinced

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a number of European allies to agree on joint production of the radar-evading Joint Strike Fighter airplane. The interesting aspect of this deal, considered the biggest military project in history, is that other nations have accepted not only the involvement of U.S. firms in their defense industry but also the United States accepting, and in fact inviting, the other countries' participation in a U.S. military project.[19]

- *Undue red tape in customs procedures*.
- *Various internal requirements, such as that the country's own system of measurement (e.g., the metric system) be used in any specifications or that a commodity be labeled in a certain way*.
- *Government subsidies or tax preferences to a nation's own firms*: Sometimes these provoke "countervailing duties" by other nations to level the playing field for their own suppliers.
- *Constraints on "portfolio investment"*: Some nations totally bar a foreigner's purchase of securities in one of the country's firms, either in general or in certain industries. Others allow a temporary co-ownership but with the provision that at some time the ownership must come to rest entirely with the country's own nationals.

Efforts to Reduce Trade Barriers. The consensus since World War II has been that the intense national protectionism that occurred during the Great Depression was a disaster. This has led to negotiations under GATT (the predecessor of the WTO), established in 1947, as a way to reduce not just tariffs but all trade barriers. By providing an international forum, GATT made it easier for each government to resist its own producer interest groups' pressures for protectionism. Since 1947, GATT negotiations, called "Rounds," have lowered many barriers, although much remains to be done. In all, there were eight Rounds. The eighth round, the Uruguay Round, was concluded in December 1993, with a signing ceremony in January 2004 in Marakesh, Morocco. It took 7 years to conclude the Uruguay Round. It addressed,

Table 7.1 Nontariff Trade Barriers

Embargoes
Quotas
Currency control
Unique performance, environmental, health, or safety requirements
Preferential treatment to local suppliers to government, e.g., military
Undue red tape in customs procedures
Internal requirements, e.g., local measurement system
Government subsidies or tax preferences to local firms
Constraints on "portfolio investment" that bars foreign investors from purchasing certain securities

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among other things, issues relating to IP rights. The most recent agreement under the WTO was the Doha Round, which started in 2001, in Doha, Qatar, and provided a mandate for negotiations, including those on agriculture and services. The Doha mandate was refined by work at Cancun in 2003, Geneva in 2004, and Hong Kong in 2005. At Hong Kong, the participating trade ministers reached an agreement that set a deadline for eliminating subsidies to agricultural exports by 2013. Also, it was argued that industrialized countries open their markets to goods from the world's poorest nations.

The WTO is the controlling agency over international trade, and it has been empowered to establish international panels to hear disputes about the decisions and laws of individual countries relating to trade. If a country does not comply with a decision after appeal, it is subject to trade sanctions or must pay compensation. For example, the WTO ruled in favor of the EU and against the United States, which was granting tax breaks on American companies' earnings from export.[20]

The central idea behind the WTO is that member nations not discriminate in their trade conduct. The normal trade relation rule (NTR), which prior to 1988 was known as the most favored nation (MFN) rule, calls for each country to give all other member nations the benefit of its lowest tariffs and least restrictive trade rules. Several exceptions have been developed, however, to allow preferential treatment for developing nations. A second rule, the national treatment rule, requires the country to give foreign goods and domestically manufactured goods equal treatment once they have entered the country. (For further information about the most-favored-nation rule and the national treatment rule, see Ref. 4, pp. 315–318.) Special rules have been worked out for free-trade areas, in which tariffs are removed among two or more nations, and for customs unions, which go a step further by setting a common tariff for countries outside the group.

The United States fought back against trade barriers with the Omnibus Trade Act of 1988, which included the "Super 301" provision, whereby a U.S. trade representative (USTR) could inform Congress if a country erected significant trade barriers against the United States or systematically discriminated against American business. In such a case, retaliation is then threatened against that country. Although successfully used against several adverse trade practices, the provision was opposed by other countries, and this experiment ended in 1991 when Section 301 was allowed to expire.

Retaliation Against Dumping. Most American states have laws against selling below cost with the intention of forcing a competitor out of business. Similar behavior, called dumping, in which imported goods are sold for "less than fair value" (LTFV), is frowned on in international trade. Fair value is determined by comparing the price with the cost of manufacture or with what the goods are being sold for at home (p. 664).[21] In the United States, the International Trade Commission, part of the Department of Commerce, investigates whether dumping has occurred and whether it has adversely affected an entire

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American industry, not just individual firms. If these facts are found, a countervailing duty is placed on the goods. In recent years, the United States has experienced some friction with Japan over alleged dumping by Japan.

Expropriation, Confiscation, and Nationalization

The power of eminent domain involves a government's taking of what previously had been private property. The exercise of this power is called condemnation. In the United States, constitutional protections apply: "Taking" of private property must be for a "public purpose," and "just compensation" must be paid. In international affairs, the power was limited from the middle of the 17th to the 19th century by the doctrine enunciated in 1646 by Hugo Grotius that no government had a right to take the property of a foreigner and that if it violated this principle it would owe the foreign owner full payment. (For a discussion of the history of international legal doctrines relative to a government taking of property, see Ref. 9, pp. 453–460.)

The term *nationalization* refers to a state's assumption of ownership. Legal literature sometimes then distinguishes between expropriation, which involves meeting the tests of "a proper public purpose" and "just compensation," and confiscation, which in one or both ways does not (p. 651).[21]

Competing Doctrines. A new form of traditional theory came into being early in the 19th century. It differs from Grotius in holding that a state may lawfully take the property of a foreigner; but it elaborates on and adds to the traditional requirements by calling for a proper public purpose, an absence of discrimination against the foreign owner, and "prompt, adequate, and effective compensation." Developed countries typically treat this as established international law. The doctrine has also been gaining increasing acceptance worldwide, both among developing nations as they take on the attitudes of developed countries and among the former communist countries as they adopt market economies.

An opposing doctrine has held sway for the past century, however, among many less developed nations, which have given private property less sanctity and have often seen themselves as exploited by outsiders. These countries have embraced the Calvo Doctrine, named after a Latin American professor, which insists strongly on the right of a government to take the property of a foreign investor and sees any intervention by the investor's home state as a violation of the sovereignty of the host government. Because they strongly assert the latter's sovereignty, these nations are known as sovereign rights states. Some remove the limits of public purpose and nondiscrimination entirely; others do not go quite so far, holding merely that there need be no showing of a public purpose as long as the foreigner is not discriminated against. In all these nations, the amount and terms of compensation tend to be far less generous than in developed countries. Before allowing foreign investment, many of these countries require the investor to

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agree to a "Calvo clause," which says that the investor gives up the right to seek assistance from its home state.

Creeping expropriation is a business risk that has its counterpart in the United States and that has grown with the increasing sophistication of governments in less developed countries. (The term uses expropriation as synonymous with confiscation, reflecting the overall lack of consistency in the use of such labels.) This consists of the host government's gradually imposing so many controls that the property's owners lose the incidents of ownership. Although the United States has sought to have it recognized, international law does not yet acknowledge the existence of creeping expropriation (pp. 83–84).[4]

Remedies. Because of all this, there is a high level of political risk for investors in less developed countries. The remedies are limited and often ineffectual. They include suing in the courts of the country that made the seizure, suing in the home country, seeking the political support of the investor's home country, resorting to an international agency, or carrying insurance against the risk.

A lawsuit brought in the courts of a less developed country is often unrewarding, since the courts there are generally not independent and the attitudes included in the Calvo Doctrine will govern. The lawsuit may, however, be brought in the investor's home state, where the hope is to collect from property that the seizing state may have there. But this route is almost entirely blocked by legal doctrines of long standing that reflect the reluctance of one nation to invite war or international friction by interfering with another.

The Philippines' Dispute With Westinghouse

During the Marcos era, Westinghouse Electric Corporation signed a contract to build a $2.3 billion nuclear power plant in the Philippines. While the construction was under way, a popular uprising toppled the Marcos government. The uprising and the subsequent free election brought to power Corazon Aquino, the wife of the slain opposition leader, Benito Aquino, as the new president of the Philippines. Shortly after the 620-MW plant was completed, the Aquino government mothballed the plant because of safety concerns. Then, it filed suits against Westinghouse. In 1993, after it lost a bribery case against the electric company in the federal court in New Jersey, the Philippines government reached an out-of-court settlement with Westinghouse.

The terms of the agreement called for Westinghouse to build two new 100-MW gas turbines at $49.5 million. In return, the Philippines government agreed to drop a breach-of-contract arbitration case pending against Westinghouse in Geneva.[22]

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One of these is the sovereign immunity doctrine. In the United States, the Foreign Sovereign Immunities Act of 1976 bars a federal court from taking a case unless the other country's actions were a form of commercial activity. In addition, there is the act of state doctrine, which declines to declare the action of a foreign government invalid, and a propensity of courts in the United States to see the other country's law as controlling in deciding the case. In the context of these intergovernmental relations, remedies for the investor are often inadequate. (For a discussion of sovereign immunity and the act of state doctrine, see Ref. 21, pp. 651–654.)

Instead of relying exclusively on a lawsuit, the investor may solicit the political help of its home state. An American investor may ask assistance from the State Department, which has the final word on whether to grant it. Subject to some exceptions, the investor must first exhaust his or her remedies within the host country. A freezing of assets, as in the case of Iran, is possible, although this does not result in immediate compensation to the investor whose property was taken. Instead, the investor must prove its claim before the Foreign Settlement Claims Commission to share in anything the American government recovers.

Resort to an international tribunal is yet another possibility. The International Court of Justice (ICJ) is, however, empowered only to decide cases between governments or cases that are instigated by agencies of the United Nations. Individuals do not have a standing to sue there. On the other hand, the International Center for the Settlement of Investment Disputes (ICSID), established at the World Bank's Washington Conference in 1965, is available to individuals and firms. About half the world's nations have ratified the convention that created the court, which handles disputes if several preconditions are met. The parties must look only to the ensuing arbitration, forgoing all court action or political assistance. (For an extended discussion of arbitration through ICSID, see Ref. 4, pp. 103–111.)

The best protection would seem to be insurance, but it is often not available. The U.S. governmental agency OPIC serves this purpose and provides risk insurance for U.S. foreign direct investment (FDI). An important limitation is that the insurance is offered only for investments in countries that have entered into an executive agreement to arbitrate any claims (doing so with OPIC itself, which will have taken as an assignment the investor's claim after paying the investor). OPIC's premium for the coverage varies with the risk. The coverage will sometimes include political violence such as terrorism, war, and revolution. OPIC is not required to insure an investment and will turn down those that are too risky. Coverage can also apply to creeping expropriation if the entire investment has been affected and if the investor agrees to abandon all rights to it. Beyond the United States, the World Bank set up the Multilateral Investment Guaranty Agency (MIGA) in 1987 to perform much the same functions as OPIC.

Privatization

The worldwide move toward a market economy in the 1970s and 1980s involved a trend that was the very opposite of nationalization. "Deregulation"

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and "privatization" (a government's passing of the ownership of property to individuals and firms) took hold in Europe, America, and many parts of the world. Then, when communism broke up in Eastern Europe and the former Soviet Union in the late 1980s and early 1990s, privatization became the byword for the transition of these areas to a market system.

Forms of privatization vary greatly. The state may issue scrip and auction the property, grant "concessions" to private operators but with the property remaining under the ownership of the government, pass ownership to those who had been employed at a certain facility or who were tenants, or just sell a sometimes less than controlling interest. In the semichaos that prevailed in the former Soviet Union following the fall of the Communist Party, much privatization occurred spontaneously without a controlling principle; people took over land and began farming, and the managers of industrial plants declared the plants as their own. Many of the powers of government were decentralized by a similar process as localities claimed autonomy.

Privatization does not necessarily imply an absence of governmental controls after ownership has passed into private hands. The whole range of governmental involvement, discussed earlier, remains possible.

International Implications of Legal Issues

The effect of some legal matters spills over national borders. The extraterritorial characteristics of these matters have a global impact. Among the issues with extraterritorial effects are securities regulations, labor law, banking, taxation, torts of subsidiaries, and antitrust law.

Extraterritoriality

Although each nation's law normally extends only to matters that occur within its borders, the extraterritorial application of law to events taking place elsewhere has been growing rapidly.

This has been evident in criminal law with the post–World War II Nuremberg trials, Israel's prosecutions of Adolph Eichmann and John Demjanjuk, and the United States' capture and prosecution of Manuel Noriega. The United States, applying the principles that have been developed internally by the U.S. Supreme Court relating to jurisdiction of state courts over nonresidents, has been the principal proponent of extraterritoriality. The principle has several applications to business practices, but globalization has made extraterritoriality a contentious issue.

The most contentious U.S. law with extraterritoriality implications is the 1996 Helms-Burton law. The law includes a number of provisions. Based on one of its provisions, any company that deals economically with Cuba can be subjected to legal action and that company's leadership can be barred from

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entry into the United States. Sanctions may be applied to non-U.S. companies that trade with Cuba. The Helms-Burton law has been very unpopular around the world. The EU, Canada, Mexico, Argentina, and other U.S. allies that have normal trade relations with Cuba have passed laws aiming to neutralize this act. These countries have argued that the law contains provisions that run counter to the spirit of international law and sovereignty.

Recent scandals and accounting misconduct by large American firms such as Enron Corporation and Global Crossing resulted in the U.S. Congress passing the Sarbanes-Oxley Act, which aimed at tightening accounting standards and restoring investors' confidence. This act will lead to profound changes in investment, banking, corporate governance, and accountancy in developed countries. Non-U.S. companies listed in the United States will have to comply with its requirements. The listed companies are required, among other things, to have an audit committee of independent directors to appoint, remunerate, and scrutinize the work of auditors. In some countries, such as Japan, independent directors are a rarity. Of course, foreign companies can delist. But by doing so, they deprive themselves of access to the biggest pool of capital on earth.[23]

The EU's commissioner for internal markets criticized this attempt, calling it "unilateralism." The reason for the criticism is that the bill requires many European companies to comply with the new rules. The act would have "extraterritorial" consequences, forcing EU auditors of European companies listed in the United States to open their books to U.S. regulators.[24] Europeans contend that certain problems may arise in implementing this law. Under German laws, for example, the management board (codetermination board, discussed in the chapter on industrial relations) takes collective responsibility. Decisions are not made by one person. Either all agree or the one who disagrees leaves the board. You cannot hold one member responsible for the decisions of the board.[25] The issues with extraterritoriality implications are discussed below (Table 7.2).

Bribery. After scandals surfaced about American firms committing bribery overseas, Congress passed the Foreign Corrupt Practices Act of 1977, which outlaws the bribing of foreign political candidates and governmental officials if the particular office exercises judgmental powers relating to the subject matter of the bribe. The act applies even though the bribe occurs outside the United States and by an individual working for an American company, who may not be an American citizen. But the act does not punish the local bribee, leaving it to the foreign state to prosecute the individual if, indeed, such a crime has taken place.

Securities Regulation. American courts have generally been willing to exercise jurisdiction over citizens of other countries, residing in those countries, to apply the American securities regulation. The federal Securities Act of 1933 relates to new issues of securities, and the Securities Exchange Act of

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Table 7.2 Issues With Extraterritoriality Implications

Bribery
Security regulations
Labor laws
Banking
Taxation
Tort of subsidiaries
Antitrust laws
Reexportation

1934 prohibits fraud in any securities transaction and has a number of rules that apply to large companies. Extraterritoriality is exercised to prevent a circumvention of those laws.

Labor Law. Historically, the U.S. Supreme Court has refused to apply American labor law to work done outside the United States, but in recent years the federal government has pressed hard to apply such law, especially antidiscrimination principles, to American businesses abroad.

Banking. The war on drugs involves a massive struggle against the smuggling of illegal substances into the United States. The federal government, seeking to prevent foreign banks from playing a role in the laundering of profits from this and other illegal activity, has gone to court to get subpoenas to serve on the banks' branches in the United States, requiring the branches to pass on information from their parent banks. This effort has not been wholly successful, since it often incurs opposition not just from other governments but from the American courts themselves.

Taxation. The United States has a strong interest in preventing wealthy taxpayers from taking up residency in a country where taxes are lower. Most countries will not tax nonresident citizens; the United States has been the main exception to the rule.

Torts of Subsidiaries. In the 1984 tragedy at Bhopal, India, more than 2,000 people were killed and 200,000 injured by a toxic gas released by a plant operated by Union Carbide India Limited, a subsidiary of an American corporation, Union Carbide Corporation. Fifty-one percent of the Indian corporation was owned by the American company, the rest by the citizens or the government of India. The plant was built, operated, and managed entirely by Indians. The American company was sued on a newly fashioned theory known as the single-enterprise theory, which argued that parent companies that have "a global purpose, organization, structure, and financial

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resources" should be liable for torts (civil wrongs) committed in any country by their subsidiaries.[b] The case was settled for $470 million. Automatic tort liability for the actions of foreign affiliates, if it comes into force, will constitute a vast extension of extraterritoriality and will enormously increase the liability exposure of companies engaged in international business.

Antitrust. Antitrust law in the United States contains a per se prohibition against some restraints on trade. An act that is illegal per se is illegal "in itself," without a court's looking at extenuating factors or overall effect. Other restraints are illegal only if they violate a rule of reason (reasonableness test) or have a reasonable probability of lessening competition. Civil and criminal penalties apply, including the possibility of treble damages (a tripling of the actual damages). The principal American antitrust statutes are the Sherman Act, which prohibits monopolies and restraints on trade; the Clayton Act, which bars certain acts if they have a reasonable probability of lessening competition; and the Robinson-Patman Act, which pertains to price discrimination.

Considerable friction has existed over the extraterritorial application of antitrust laws by the United States and the EU. Largely because of the American treble damage remedy and the exemption granted to export associations, Britain has joined in the opposition voiced by many less developed countries. Some countries have adopted "blocking legislation," and courts overseas have sometimes ordered one citizen of a country not to sue another citizen on an antitrust matter in American courts.

The Foreign Trade Antitrust Improvements Act of 1982 gave a statutory basis to earlier court decisions that extended American antitrust law to the behavior of foreign entities. For a court to apply American law, it must find several things: (1) that the anticompetitive act had, or was intended to have, a substantial effect on either American exports or internal commerce; (2) that the behavior was of the sort that would violate U.S. antitrust laws; and (3) after considering the need for international comity, that the American interest in regulation outweighs the interest of the other country in governing the activity.

It is argued that uniform antitrust laws could contribute to opening world markets and limit barriers to trade. Certain limitations, however, prevent uniformity of antitrust laws. Among the limitations are considerations of sovereignty, concerns about sharing confidential information, differences in competition policy between emerging and more established economies, and the varying role of trade policies among nations.[26]

Reexportation. As we saw in the earlier discussion of governmental restrictions on trade, it is illegal to export a good on the commodity control list to an embargoed country. This takes on an extraterritorial aspect in light of the responsibility that is placed on the American exporter to see to it that the recipient in one country does not send the goods on (reexport them) to someone at a prohibited destination.

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Contract Enforcement

Those engaged in international business will want to do everything possible to arrive at enforceable contracts. This requires knowledge of desirable contract provisions, the rules of law that apply, how payment is made, and the enforcement of judgments.

Contract Provisions. It is wise to include certain provisions in an international contract. One is a forum selection clause by which the parties agree on which nation's courts are to have jurisdiction over a dispute if one arises. These should be crafted with competent legal advice, since the clause will not be enforced if it seems inequitable for any of several reasons. Another is a choice-of-law clause specifying which country's law should be applied by the court hearing the dispute. The 1986 Hague Convention on the Law Applicable to Contracts for the International Sale of Goods, also known as the Choice-of-Law Convention, lets the parties freely pick the law to be applied. Along similar lines, a choice-of-language clause is desirable, to select the language in which the contract will be construed. A **force majeure** clause is also common. This provides for a party to be excused from performing if prevented from doing so by a force—such as war, expropriation, strikes, flood, embargo, and the like—that is beyond the party's control.

Law Relating to Sales. In the United States, the UCC was adopted in the early 1960s by all states except Louisiana, which derives its law from the Napoleonic Code. For international transactions, however, a source of law that is rapidly being adopted around the world is the United Nations' Convention on Contracts for the International Sale of Goods (CISG), which took effect in 1988. (The CISG is dealt with extensively in the chapter on sales in Ref. 4, pp. 422–474.) CISG preempts any given nation's law if the parties' respective countries have adopted the convention (the United States is among those that have done so). However, if the contract includes a choice-of-law clause, then the law of a member nation is applicable. CISG relates to sales between merchants, not to consumers. It speaks to issues relating to the formation of the contract and remedies, but it doesn't deal with matters of competency, lawful purpose, product liability for harm caused by goods, or the rights of third parties. These exclusions suggest that parties should continue to include a choice-of-law clause to cover those matters.

The CISG is partly based on the UCC and partly on the concepts that are inherent in European civil law. Among its principles, which frequently differ significantly from those of the UCC, are the following rules.

Way of Paying Obligations. Since the mid-1970s, rather than use the mail or telex, firms in a large number of countries have made payments of money owed to others under contracts through the Society for Worldwide Interbank

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Financial Telecommunication (SWIFT), by which banks transfer funds rapidly from a buyer's bank to that of a seller.

Enforcement of Judgments. Can a judgment against an MNC be enforced in other countries besides the country where the judgment was rendered? The answer is yes, but there are caveats. Assume that one party sues another in the courts of a certain country for breach of contract and obtains a judgment in that country's courts. The collection of the judgment can possibly be obtained in yet another country through the entry of a separate corresponding judgment there. The courts of the second country generally do not require a new trial on the merits. They will recognize the foreign judgment in their country and statutorily extend comity to the judicial actions of the other nation.

This does not, however, work with perfect symmetry. While American courts will usually enforce foreign judgments in the absence of a strong public policy reason not to, many other countries attach conditions to enforcing U.S. judgments. Countries differ in the types of remedies they prefer. Specific performance is more commonly used than money judgments in many countries. In specific performance remedy cases, the court orders a party to do what it promised under a contract.

Patents, Copyrights, Trademarks, and Trade Names

As noted previously, intellectual property rights (IPRs) may constitute a valuable part of the assets of a firm doing business internationally. (See the chapter on intellectual property in Ref. 4, pp. 586–664; Ref. 9, pp. 425–452.) It becomes important to protect the exclusivity of these rights by blocking unauthorized use. One of the more effective ways to protect an IPR, where the situation fits, is to maintain an unpatented right as a trade secret. Coca-Cola, for example, for more than a century has kept its formula secret. So long as careful steps are taken to maintain the secrecy, the law of individual countries, or the law of individual states in the United States, relating to trade secrets provides remedies in case of theft.

The international registration of patents and trademarks is governed by the 1883 Paris Convention for Protection of Industrial Property. Copyrights are governed either by the Berne Convention, promulgated in 1886 (revised in 1971), or the Universal Copyright Convention. Ninety-three countries belong to one, the other, or both. The conventions are administered by the World Intellectual Property Organization (WIPO), established in 1967.

Patents, Trademarks, and Trade Names. The Paris Convention does not provide a one-time, universally valid patent, trademark, or trade name registration (although the Madrid Convention does set up such a system for trademarks and trade names among its participating nations not including the United States). Instead, a separate registration is needed within each

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country where protection is desired, and the laws of different countries vary widely. Patent protection starts from the time an application is filed, and if an application is filed in another member country within 1 year of the initial filing, the protection in the second country dates back to the day on which the application was filed in the first country. This 12-month rule is called the "right of priority." A similar dating back applies to trademarks if the filing in the second country is done within 6 months. Some countries, including the United States, will judicially protect a trademark on the basis of its use even if it is not registered. Subject to some exceptions, U.S. patents are good for 20 years from the day the application is filed. In other countries, the period varies from as low as 5 years to as much as 20 years.

The Paris Convention's national treatment rule requires that each member nation give foreign applicants the same protection it gives its own citizens, without discrimination. The common rules principle sets down certain guidelines for all member nations to follow, although much is then left to the nation's own laws.

Copyrights. A one-time registration of copyright is available among the nations that have subscribed to the Berne Convention, so that the claimant need not register in each country. A major issue in recent years has been the protection of computer programs, since imitation can escape copyright protection if the programming is sufficiently rearranged. The trend in the technically advanced nations is to shift to a patent rationale. A mixed system of patent and copyright has been established for computer chips. The Uruguay Round of the GATT negotiations gave considerable attention to current issues relating to all forms of IPRs.

In 1996, the WIPO in Geneva adopted two international treaties on copyright protection. It extended protection—in countries that sign on—to any kind of copyright content distributed online, such as software, music, and multimedia. It also established that countries would pass laws to make hacking into online music and film subscription services and piracy of CDs and DVDs illegal.[27]

Transfer of IPRs. The owner of an IPR may use it itself, convey it to another firm, or give a license (exclusive or nonexclusive) to one or more users. If the owner franchises the right, the owner gives a license and retains a large amount of control over its use. Many countries will grant a compulsory license to a potential user, without getting the owner's approval, if a certain period of time passes without the owner's using the IPR in the country's market.

Finally, since in effect IPRs are legally protected monopolies, given as an encouragement to invention, countries have developed a large body of law that concerns itself with anticompetitive features and specifies how the monopoly can be used. For example, most countries will treat as illegal price fixing an agreement between an IPR owner and a licensee concerning the price the licensee will charge its own customers.

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International Boycott

In addition to the antitrust matters discussed in relation to extraterritoriality, it should be noted that it is illegal under the Export Administration Act of 1979 and the Internal Revenue Code for Americans either to take part in or to cooperate with an international boycott (concerted refusal to deal). Historically, the primary purpose of this provision was to prevent American participation in the Arab states' boycott against Israel. In fact, Americans are required to report to the Internal Revenue Service any request to take part in a boycott and any request to provide information about the religion or national origin of customers, employees, or suppliers. The U.S. government approves certain boycotts, however, such as the one that existed for several years against South Africa, and it is lawful to participate in those.

Many countries have merger legislation that in various ways limits acquisitions by foreign firms of part or all of a domestic company. Most particularly, developing nations want their own citizens to own at least part of each enterprise.

MNC Operational Disputes

MNCs face a number of potential operational disputes that can hamper international business.

Industrial Relations

The labor legislation that applies to international businesses is the law of the country in which employees are working, subject to certain conditions. For example, the extraterritorial effect of the law of the employees' country of origin is applicable if the employees are not natives of the host country. The International Labor Organization (ILO), an agency of the United Nations, has proposed more than 150 conventions. A convention is an agreement, sponsored by an international organization, between two or more countries. Regional treaties also exist within such areas of the world as the EC. Primarily, however, the law of a specific nation is enforceable when there is no international agreement in place or that country has persistently objected to international customary law. It is essential that an international business get to know the labor laws and customs of the nations with which it deals, since they may differ greatly from those in the United States. Most employees, for example, are employed at will in the United States, but in a nation such as Japan there is an expectation of a long-term commitment.

The ILO seeks the adoption of standards by its member nations, proposes recommendations and conventions, and conducts conferences. Its administrative tribunal hears specific cases only involving employees of intergovernmental organizations (IGOs), such as the ILO itself. (For a lengthy discussion of the ILO, see Ref. 4, pp. 259–268.)

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The situation regarding collective bargaining will vary depending on the strength of union organizations, labor militancy, and the extent to which union activities such as picketing and boycotts have been under legal constraint. Various aspects of labor relations are discussed in Chapter 12, on industrial relations. Here, we will only refer to pertinent legal issues.

Many countries set limits on the right to dismiss employees and to relocate or close plants. The United States requires early notification for layoffs. In Germany, the company must work through the works council, which can insist on arbitration. The discharge of an employee often requires consultation with the union, as in Britain, or with the works council, as in Germany. In the United States, union contracts invariably provide a grievance procedure, culminating in arbitration, in cases of employee discipline.

To be employed as a foreign worker in a country, a person must obtain the necessary visa and work permits and must conform to the same laws as observed by workers of that country. In addition, myriad regulations exist regarding pay, working conditions, the percentage of foreign workers who can be employed, who will pay for their return to their home countries, and so on. Sometimes, there are prohibitions or restrictions on a worker's right to send his salary home.

Many countries have compensation systems for injury on the job. Worker's compensation, a compulsory insurance system, is prevalent in the United States, where it was copied from legislation in Bismarck's Germany. Countries generally provide for private insurance, a governmental fund, or a combination of both.

Environmental Laws

The developed nations have devoted increasing resources to protection of the environment, and most have extensive laws dealing with responsibility for and cleanup of pollution. This has not come nearly so far in the developing countries and the former communist states. Businesses, however, must be aware that as these countries improve economically, lax standards, where they exist, may soon be tightened.

Internationally, the United Nations Environmental Programme (UNEP) is actively generating a series of agreements, supplemented by guidelines. More than a hundred countries, for example, have joined the Basal Convention on Transboundary Movements of Hazardous Wastes and Their Disposal. This convention mainly addresses problems arising from one country sending wastes to another (often a less developed country) for disposal. (International environmental issues are examined in Ref. 9, pp. 517–527.)

Transfer Pricing and Earning Stripping

As discussed in previous chapters, often there are ways in which MNCs can reduce the taxes paid to host countries. Where a business has operations

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located in more than one taxing jurisdiction, and there are transactions among the company and its affiliates, taxes can be minimized for the enterprise as a whole. To do so, MNCs can set the charges made on the transactions so that the affiliate in the state or country with the lowest tax makes all or most of the profit. This is called transfer pricing (pp. 720–725).[4] Transfer pricing is the source of much dispute between host countries and MNCs. While flagrant cases of abuse are often detected, most subtle cases remain hidden. When, for example, MNCs use the same price for products sold both to subsidiaries and unrelated firms, these transactions may be different. Subsidiaries may receive different financing terms, warranties, advertising support, and after-sales services. In such cases, what appear to be equal and fair prices offered to both parties in fact are not.[28] It appears that foreign-owned MNCs operating in the United States are reporting significantly less profit for their U.S. operations than their U.S. counterparts. In 1987, for example, U.S.-owned firms reported an average of 2.9% return on assets, nearly four times that of their foreign competitors.[28] Since 1980, sales by foreign firms in the United States have been steadily rising, reaching more than $540 billion in 1986. Their reported profit, however, barely changed during the same period. In 1986, only 43% of 36,800 foreign-owned companies reported any taxable income. They claimed deductions of $543 billion on only $500 billion of revenues.[29]

Besides transfer pricing, there are other schemes used by some MNCs to reduce or avoid taxes. "Earning stripping" is one such scheme. Earning stripping takes place when a foreign company uses big loans instead of direct capital investment to finance its operations. The interest on the loan is a tax deduction, which reduces the taxes owed by the firm. It is estimated that foreign firms operating in the United States, using various tax schemes including transfer pricing and earning stripping, avoid more than $3 billion in taxes annually. A 1994, U.S. law closed a loophole that was allowing foreign companies operating in the United States to use earning stripping. While not totally eliminating their deduction, the law increased the cost to those companies. These companies complained that they are discriminated against compared with their U.S. counterparts, which do not face similar debt-to-equity rules.[30]

There are a couple of ways by which governments with higher tax rates can defeat this. The more common one is to apply the arm's length principle. Here, the taxing authorities use a variety of standards to adjust the prices that one entity has charged another, seeking to make them comparable with what independent firms would have charged each other. Under this principle, the taxing agencies determine what profit each entity has made.

The other approach is the unitary business rule. Here, the taxing authority starts with the total profit made everywhere by the international business and then decides what part of that profit should be attributed to the affiliate within its jurisdiction. Percentages are developed based on the relative amounts of sales, property owned, and wages paid both worldwide and locally. American law adopts the arm's length principle for the federal government, but some states use the unitary business rule.

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Increased business transactions on the Internet have created a new problem. At its core is the question of jurisdictional issue. How should sales taxes, if any, be collected, and on what basis? How should they be distributed? If a dispute arises between parties in different countries, which country's law applies? While efforts are under way to create a universal set of rules, some countries have taken the matter into their own hands. For example, Australia's highest court recently shook up Internet law with a ruling that Dow Jones, the U.S.-based news group, could be sued in Australia for defamation over an article on its Web site.[31]

Research and Development

The Tokyo Round of the GATT negotiations took place between 1973 and 1979. Among other things, it produced a Product Standards Code that set up a mechanism to create internationally recognized norms for product characteristics and product descriptions. Each member nation is required to have a central standards office, which for the United States is the National Center for Standards and Certification Information, which is maintained by the Department of Commerce's National Bureau of Standards.

Technology is often transferred in international trade, and provisions are sometimes put into contracts attempting to place constraints on the recipient. Those engaged in international business need to know that such constraints are often illegal.

Most countries outlaw a transferor's placing restrictions on further research and development by the transferee, either as to the improvement of the technology itself or as to a competing technology. The United States allows restrictions where there is a legitimate business interest to be served, such as shielding the transferor from legal responsibility or safeguarding the technology's reputation.

Grant-back provisions also have legal nuances that can make them illegal. Provisions of this sort require users of technology to share the knowledge gained through the use of the technology. The provisions can be reciprocal, where both parties must share information; or unilateral, where only one (ordinarily the licensee) must. Those that are unilateral are illegal in most countries, although the United States considers them so only if, given the market situation, they have an adverse effect on competition.

Summary

This chapter touches on a great many areas of law relating to international business, but it is important to be aware that many more areas exist and are changing all the time. A single chapter leaves many topics untouched and gives only a broad outline of the law on the topics selected. Even textbooks

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devoted entirely to the law of international business only scratch the surface, giving a snapshot in time of the law as it existed at the time of the writing. Business firms find it necessary to go beyond a general knowledge and to master, with the aid of competent professional advice, the many specifics, often nation by nation.

The primary purpose of this chapter is to create an awareness of legal issues so that a person or firm doing business internationally will seek competent legal advice.

Discussion Questions

1. Is the position of the dissenting justices in the GE and Honeywell case (see the chapter vignette) similar to that of the Indian courts in the Bhopal case? Discuss.
2. What does each of the following acronyms stand for: IPRs, CISG, GATT, EEC, NAFTA, OPIC, COCOM, MFN?
3. What is a GATT round?
4. What basically did the Foreign Corrupt Practices Act of 1977 do?
5. How is the Mitsubishi Group organized?
6. Give four examples of the differences in attitude and policies between the developed and the less developed nations.
7. How does Subpart F of the Internal Revenue Code fight tax havens?
8. Describe the foreign exchange market.
9. What are the steps in the U.S. entry process for imports?
10. What is an embargo, and how can an exporter check to see whether it is lawful to export a certain item?
11. What are the two types of American export licenses?
12. Name six nontariff trade barriers.
13. What is dumping, and how is it generally handled?
14. What distinction is sometimes made between expropriation and confiscation?
15. What doctrines and court practices make it difficult to win against a host state in a lawsuit brought in a home state?
16. When is OPIC insurance available to cover the risk of confiscation by a host state? What form of relief would a claimant be entitled to?

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17. What factors must a court find present to apply American antitrust law to the behavior of foreign entities under the Foreign Trade Antitrust Improvements Act of 1982?

18. What is transfer pricing, and what steps are taken to defeat it?

Notes

a. I gratefully acknowledge the contributions of Dwight D. Murphey, Wichita State University, and Karen Beyke, who taught International Business Law at Coles College of Business, Kennesaw State University for 7 years.

b. The case in which the U.S. Court of Appeals (Second Circuit) recounted the details of the Bhopal accident and held that the dispute should be heard in India, not the United States, is *In the Union Carbide Corporation Gas Plant Disaster at Bhopal*, 809 F.2d 195 (1987).

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