THE PHILIPPINES-UNITED STATES TAX CONVENTION: SUGGESTIONS FOR A PERSPECTIVE

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PART II

II. Tax Convention in Perspective

Introductory Note

Our discussion of the proposed Philippines-United States tax treaty in the first part of this paper should serve to project in detail the techniques by which the basic assumptions underlying the development of tax conventions are formulated into a definite policy instrument. An understanding of these assumptions, for one, will help us explain the practical value of a tax treaty to the contracting states. Our interest in the matter, however, goes beyond the study of specific benefits arising from a particular agreement: we are interested as well in a survey of these assumptions as part of the effort to explain the broader context in which tax convention as an institutional response to world economic situation should be seen. This effort, it is hoped, would lead us to a logical interconnection of several developments starting, for our purpose, with the emergent function of tax convention in under-developed economies down to the forces which have shaped the imperatives of international trade and investment. Within this framework, tax convention merely represents a process of integrating the various tax jurisdictions into some international tax law. This process in turn is an aspect of a broader movement to unify legal systems around the principle of protecting property, particularly private property invested for profit in a foreign country. On the whole, this is easily recognizable as a built-in necessity in international investment and financing, which has significantly grown roughly since the end of the second world war. Correspondingly, since that time capital-exporting countries have intensified their campaign for the "rule of law" particularly addressed to the under-developed nations of Africa, Asia, and Latin America — countries which, as colonies or semi-colonies despite a show of political independence, have been the traditional situs of raw material development and market outlets for finished products. In this narrow context, they are the appropriate object of some kind of an educational drive intended to teach them the

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law of "civilized nations", with emphasis on respect for business property rights of aliens.[1]

There should be no dispute on this: the main thrust of recent developments in international law is the encouragement and protection of foreign investment. The focus of this orientation is the under-developed nations, a fact which coincides with the shift of investment direction toward these regions. What remains at issue is how this phenomenon should be explained. The position of the capital-exporting countries on this question is represented by the view that since by the nature of their economy under-developed countries could not generate capital resources for economic development, necessarily their capital requirements could only be met by relying on foreign capital. And to attract foreign capital under-developed countries should not only eliminate deterrents to foreign investment but provide a wide range of incentives as well. Concomitantly, they have to make adjustments in their legal system to accommodate the demands of foreign capital the entry of which, it is assumed, is now predominantly inspired by a beneficent mission to bring good life to the peoples of under-developed countries. This picture is far from complete. On the other hand, the development of the tax convention in relation to American foreign economic policy as discussed here shows that the imperatives to export capital on the part of the industrialized capitalist nations in the West (as represented by the United States in the present discussion) is determined more by the needs arising from the surplus-producing capacity peculiar to their social structure than by the capital requirements of under-developed countries. As thus conceived by the highly industrialized capitalist countries, economic development of under-developed nations by foreign capital is a strategy of self-interest rather than a beneficence of authentic assistance.

Necessarily, in a paper like this the most that can be worked out is merely an outline presentation of what I think are the decisive elements of the framework within which we propose to examine the tax convention. At any rate, the intention here is to achieve only that much. It is hoped that this framework could be of some value in deciding whether the Philippines should accept the tax convention as developed in the highly industrialized economies of the West.

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1 "Some of the answers for the less-developed areas lies in the education of foreign countries on [investment] climate matters . . . Too few governments are as yet convinced that investments must be worked for and must be encouraged." Statement of Charles B. Warden in *Hearings on the Mutual Security Act of 1957 Before the Senate Committee on Foreign Relations*, 85th Cong., 1st Sess. 569 (1957), quoted in Morray, *Aid Without Tears: Opportunism in Foreign Development Policy*, 46 CALIF. L. REV. 663, 685 at note 125 (1958).

Premises of Tax Convention

So far as it can be ascertained, the first tax agreement was formally concluded in 1843, between Belgium and France concerning problems in double taxation and tax evasion.[2] Aside from this one, only three other agreements are known to have been concluded in the nineteenth century.[3] It is significant that the first three tax conventions were entered into between Belgium and the three countries with which it has common boundary.[4] This fact may as well epitomize the rationale behind the early stages in the development of tax convention.

This beginning appears an isolated event. For it was not until the 1920's that tax convention emerged as a distinct device in international tax relations,[5] originating anew from intra-European trade. Germany, the industrial heartland of continental Europe, took the initiative in building what was soon to become a network of tax agreements. In the first half of the twenties, it concluded separate agreements with Czechoslovakia, Austria, Poland and Switzerland — countries with which it has common boundary.[6] This period saw a multilateral convention on avoid-

[2] Convention Regulating the Relations between the Administrative Services of France and Belgium, August 12, 1943. See UNITED NATIONS DEPARTMENT OF ECONOMICS AFFAIRS, INTERNATIONAL TAX AGREEMENTS (1948) at Index of International Tax Agreements, 1843-948, hereinafter referred to as UN Index. Also Bloch & Heilemann, *International Tax Relations*, 55 YALE L.J. 1159, 1170-1171 (1946), at note 40. The development of tax conventions has been related to temporary agreements suspending dues and imposts during the Middle Ages to encourage trade fairs. See King, *Tax Conventions to Which United States is a Party*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 479, 484 (1960). But those agreements belong to an entirely different context. Our discussion concerns tax relations of national states.

[3] Convention Regulating the Relations between the Administrative Services of Belgium and the Netherlands, May 24, 1845; Convention Regulating the Relations between the Administrative Services of Belgium and Luxemburg, October 11, 1845; and Declaration between United Kingdom and Switzerland Relative to Succession or Legacy Duties on Property of British Subjects Dying in the Canton de Vaud or of the Citizens of the Canton de Vaud Dying in the British Dominions, August 27, 1872. See UN Index, *supra* note 2.

[4] France, the Netherlands, and Luxemburg.

[5] The gap was punctuated by three special agreements on transfer taxation: Arrangement between France and United Kingdom for the Prevention of Frauds in Connection with Succession Duties, November 15, 1907; Convention between Germany and Greece Concerning Succession Duties, November 18 and December 1, 1910; and Convention between Spain and Greece concerning the Succession to Property of Spanish Subjects Deceased in Greece and Greek Subjects Deceased in Spain, March 6, 1919. See UN Index, *supra* note 2. But see UNESCO, *Treaty Provisions for the Avoidance of Double Taxation of Copyright Royalties*, 7 COPYRIGHT BULLETIN 19 (1954).

[6] Treaty between Germany and Czechoslovakia for the Adjustment of Taxation at Home and Abroad, in Particular for the Avoidance of Double Taxation in the Field of Direct Taxation, with Final Protocol, Prague, December 31, 1921, 17 L.N.T.S. 402; Treaty between Germany and Austria for the Equal Distribution of Taxes at Home and Abroad, and in Particular for the Prevention of Double Taxation in the Field of Direct Taxation, with Final Protocol, Berlin, May 23, 1922, 26 L.N.T.S. 406; Arrangement between Germany and Poland Concerning the Provisional Abolition

ance of double taxation among neighboring countries in central and southern Europe.[7] That interest in tax relations was generally limited to adjacent or neighboring nations was emphasized by bilateral agreements between France and Saar[8], France and Monaco,[9] Poland and Danzig,[10] and between Hungary and Italy[11] — all concluded in the same period. By the end of 1930, no less than 90 tax agreements inter-connected almost all countries of Europe, with the industrial centers forming the nuclei.[12] Up to the next decade ending in the outbreak of the second world war, leadership in tax treaty-making clearly indicated commercial and industrial potential. Thus, Germany had 36 treaties from 1921 to 1940; 25 of these sought relief from double taxation and the rest provided arrangements for legal and administrative assistance in tax matters. Belgium concluded 22 agreements in a ten-year period beginning 1928. From 1922 to 1940, France had no less than 32 tax treaties, 25 of which secured relief from double taxation with all countries surrounding it. United Kingdom had about 22 treaties from 1924 to 1939. Other leaders during the same period were Denmark, Netherlands, Sweden, and the United States. By 1940, about 200 tax conventions had been concluded.[13]

The marked prevalence of tax convention in the two decades preceding the second world war reflected the difficulties of capital and commodity movements during this period of "economic balkanization." As the volume of international trade and investment grew, overlapping of tax jurisdictions was increasingly felt as a barrier in that it resulted to double or multiple taxation upon the same income as it flowed across political boundaries. This problem became the major concern of the

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of Double Taxation, Dresden, March 21, 1923, 34 L.N.T.S. 316; and Treaty between Germany and Switzerland for the Prevention of Double Taxation in Respect of Earned Income, with Final Protocol, Berlin, March 24, 1923, 27 L.N.T.S. 42.

7 Convention for the Purpose of Avoiding Double Taxation between Austria, Hungary, Italy, Poland, Romania, and the Kingdom of the Serbs, Croats and Slovenes, April 6, 1922. See UN Index, *supra* note 3; 20 L.N.T.S. 12.

8 Convention Designed to Prevent the Duplication of French and Saar Taxes, Paris, July 5, 1922, 27 L.N.T.S. 266.

9 Agreement for the Prosecution and Suppression of Fiscal Frauds, June 26, 1925. See UN Index, *supra* note 2.

10 Agreement with a View to the Adjustment of Taxation for the two States and in Particular the Prevention of Double Taxation in the Matter of Direct Taxes, with Final Protocol, March 17, 1924. See UN Index, *supra* note 2.

11 Convention for the Prevention of Double Taxation and the Settlement of other Questions Connected with Direct Taxes, and Final Protocol, November 25, 1925. See UN Index, *supra* note 2.

12 See UN Index, *supra* note 2.

13 See *ibid.* Also Carroll, *Tax Inducement to Foreign Trade*, 11 LAW & CONTEMP. PROB. 760, 761 (1946).

League of Nations,[14] whose expert studies and model tax treaties fostered the development of the modern tax convention..[15]

The emergence of conflicts in international tax relations came in the wake of the tremendous expansion of productive capacity in the highly developed countries. During the same period, creditor nations began their intensive search for political and economic integration calculated to remove obstacles to the creation of markets for finished products and investment outlets for surplus capital. They advocated free trade and under the bannner of economic internationalism they advanced to new frontiers of profit. The most distinctive feature of this internationalism, to cite Hobson, was not the growth of ordinary commerce but the increasing investment of capital in foreign countries.[16] In this light, the work of the League of Nations was significant: it re-examined the traditional bases of taxation in relation to the conflicting claims of debtor and creditor nations and their effects on the flow of capital.[17] In the meantime, as the domestic economy slumped in the face of glutted market and vanishing investment opportunities at home, the need for expanding trade and investment became critical. Beginning in 1921, this failure of the capitalist economy culminated in the collapse of the world economic structure, characterized by a wave after wave of depressions extending up to the outbreak of the second world war.[18] Thus, the demands of the highly developed economies in a period of general crisis gave impetus to shaping the now established role of tax conventions in eliminating "the barriers to the international flow of commodity and capital."

In the post-war period, international trade and investment resurged, with even greater demand to capture foreign markets. As capital-exporting countries accelerated their drive to penetrate the far corners of the world with goods and capital, multi-national taxation obtruded once more as a barrier to the desired scope and direction of capital outflow. This accentuated the importance of tax convention as a vehicle for the development of "a rational system of taxing international transactions."

This brief historical survey suggests two things. First, in intra-European trade double taxation and fiscal evasion, at the start, became

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[14] See Wang, *International Double Taxation of Income: Relief Through International Agreement* 1921-1945, 59 HARV. L. REV. 73 (1945).

[15] Bloch & Heilemann, *supra* note 2.

[16] HOBSON, THE EVOLUTION OF MODERN CAPITALISM 460 (1954).

[17] See Wang, *supra* note 14.

[18] See EATON, POLITICAL ECONOMY 236-240 (1966); CARR, INTERNATIONAL RELATIONS BETWEEN THE TWO WORLD WARS, 1919-1939 chap. 7 (1966); DOBB, STUDIES IN THE DEVELOPMENT OF CAPITALISM chap. 8 (1963). Also Hexner, *Worldwide International Economic Institutions: A Factual Review*, 61 COLUM. L. REV. 354, 357 (1961).

a problem common to adjacent countries as the commerce of one, if only for the fact of physical proximity, naturally flowed into the territory of another. That the problem was of common concern to both sides is explained by the two-way flow of trade.[19] Under these conditions, the tax treaty necessarily reflected reciprocal interests; the agreement was practically a *quid pro quo* transaction. Secondly, as international interests of industrialized nations proliferate, incidents of double taxation multiply and more income earned abroad by their nationals escape taxation. Their trading and investment capacity is precisely the compulsion to seek diplomatic means by which the negative impact of taxation on foreign trade and investment is neutralized by preventing double taxation. The institution of tax convention, therefore, finds its proper context in the demands of a highly developed economy for a free movement of goods and capital; it is a specialized function of its industrial and financial potential. As the tax convention historically developed, its reciprocal character has been basically determined by the fact that the contracting parties belong to the same level of economic development.[20] It is significant to note in this connection that the latest step toward a consensus in taxation of international transactions has been achieved by the developed countries which contribute some 90 per cent of the total capital outflow to under-developed nations and control about 60 per cent of the total volume of world trade.[21] Through their Organization for Economic Cooperation and Development (OECD), they have prepared a Draft Double Taxation Convention as the basis of integrating the various tax systems for the expansion of international trade and investment.[22]

United States Treaty Pattern

Pre-war period. The United States concluded its first tax agreement with Denmark in 1922. It was a special agreement, restricted to reciprocal exemption of shipowners from income tax.[23] Of about 17 tax agreements it entered into from 1923 to 1939, 13 sought relief from

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19 See Kust, *Tax Treaties with Underindustrialized countries* in SHAW (ed.), LEGAL PROBLEMS IN INTERNATIONAL TRADE AND INVESTMENT 197, 199-200, 209 (1962).

20 See Rothkopf, *Current Development in the Field of International Tax Affairs,* 44 TAXES 87, 92 1966).

21 Carr, *The World in Figures: International Capital Flows,* 7 PACIFIC VIEWPOINT 101 (1966); Hexner, *supra* note 18, at 372.

22 See Kragen, *Double Income Taxation Treaties: The O.E.C.D. Draft,* 52 CALIF. L. REG. 306 (1964); Hexner, *supra* note 18, at 371-73. The O.E.C.D. is composed of the United States, Canada, and 18 European countries.

23 Exchange of Notes Regarding the Reciprocal Exemption of Shipowners from Income Tax, October 24 and 28, and December 4, 1922.

double taxation but with respect only to shipping profits.[24] Its treaty with Japan in 1926 secured reciprocal exemption from income tax of profits from operation of merchant vessels.[25] This indicates that during this period the interest of the United States in the problem of double taxation and, hence, in tax agreements, was generally limited to ordinary maritime commerce.

In the last part of the thirties, a change in the pattern of American treaty-making became discernible — a development which could not be adequately explained by commerce in terms merely of export of commodities. The U.S. convention with France in 1935 mainly dealt with the tax treatment of income of corporations of either state doing business through branches or subsidiaries in the territory of the other.[26] The convention was principally aimed at the double tax problem created by the French dividend tax of 1872, "which was particularly obnoxious to foreign corporations with interests in French concerns."[27] It was the treaties with Sweden and France in 1939,[28] and with Canada in 1942[29] that set the stage for its post-war pattern in general income tax conventions. The treaty with Sweden avoids double taxation through the device of foreign tax credit.[30] It adopts the permanent-establishment concept in the exemption of industrial and commercial profits,[31] and defines "permanent establishment" in terms identical to the provisions of the proposed Philippines-United States convention.[32] Exemption is ac-

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[24] These agreements were generally with developed countries, including Germany, United Kingdom, Canada, and Sweden. See UN Index, *supra* note 2.

[25] Exchange of Notes Regarding the Reciprocal Exemption from Taxation of Income Derived from the Operation of Merchant Vessels, March 31 and June 8, 1926. See UN Index, *supra* note 2.

[26] Convention and Protocol between the United States of America and France about Double Taxes, April 27, 1932. See UN Index, *supra* note 2.

[27] Wang, *supra* note 14, at 107-108.

[28] Agreement and Protocol between the United States of America and Sweden for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative Assistance in the Case of Income and Other Taxes, Washington, March 23, 1939, 199 L.N.T.S. 17 (effective January 1, 1940); Convention between United States of America and France for the Avoidance of Double Taxation and for the Establishment of Rules of Reciprocal Administrative Assistance in the Case of Income and Other Taxes, Paris, July 25, 1939, 125 U.N.T.S. 259 (effective January 1, 1945). The Convention with Sweden is still in force as supplemented by Convention of October 22, 1963, T.I.A.S. No. 5656; and the Convention with France, as supplemented by Convention of October 18, 1946, 140 U.N.T.S. 50 and Convention of June 22, 1956, 291 U.N.T.S. 101.

[29] Agreement between the United States of America and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Washington, March 4, 1942. This is still in force as supplemented by Convention of June 12, 1950, 12 U.N.T.S. 67 and Convention of August 8, 1956, 293 U.N.T.S. 344.

[30] Treaty with Sweden, art. XIV. See *supra* note 28.

[31] *Id.*, art. II

[32] As to definition of "permanent establishment", compare art. 8 of proposed Philippines-United States convention with Protocol of Sweden-U.S. treaty.

corded to royalties derived from one of the contracting states by a resident or corporation of the other contracting state as consideration for the right to use copyrights, patents, trademarks, and other analogous rights.[33] Other important features of the treaty were to become familiar as standard rules in United States tax conventions after the war. Income from real property is taxable in the country of location.[34] Personal services income is to be taxed in the state where the services were performed.[35] Fiscal cooperation is instituted in the form of exchange of tax information, administrative assistance in tax collection, and provision for taxpayer's claim based on treaty rights.[36] The treaty with France and with Canada follow the same principles.

Post-war period. Soon after the war, the United States concluded general tax treaties with the United Kingdom, Netherlands, Belgium, and Denmark.[37] This was taken to mean as supporting the policy of encouraging American investment in Western Europe.[38] Within a decade the United States signed 14 of such treaties.[39] As of 1965, 22 tax treaties are in effect and about four more have been signed but not yet operative.[40] More than half of the treaties in force are with countries in Western Europe; only three are with the under-developed nations.[41]

The basic framework of these conventions follows the 1939 conventions with Sweden and France. Since then "there have been few significant departures."[42] In general, their features are designed especially to promote foreign investments, or export of capital as distinguished from export of commodities. Thus, rules on investment income, personal services income, foreign tax credit, and nondiscrimination are standard provisions of post-war conventions.

That the treaty-making offensive should take this line is understandable enough. After the second world war, the United States emerged as the leading creditor country.[43] This change of capital position did

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[33] Treaty with Sweden, art. VI.

[34] *Id.*, art. V. Compare with art. II of proposed treaty with U.S.

[35] *Id.*, art. XI. Compare with art. 13 of proposed treaty with U.S.

[36] *Id.*, arts. XVI, XVII & XX. Compare with arts. 19 to 27 of proposed treaty with U.S.

[37] See UN Index, *supra* note 2; Owens, *Role of U.S. Income Tax Treaties in Relieving Double Taxation,* 4 INSTITUTE ON PRIVATE INVESTMENTS ABROAD, 109-110 (1962).

[38] See Owens, *supra* note 37.

[39] *Ibid.*

[40] See Slowinski, Haderlein & Meyer, *International Tax Treaties: Where Are We-Where Are We Going?* 5 VA. J. INT'L. L. 13 (1965).

[41] Rothkopf, *supra* note 20; Owens, *supra* note 37.

[42] Slowinski, Haderlein & Meyer, *supra* note 40, at 170.

[43] See Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice,* 5 AM. J. COMP. L. 229, 231, note 7 (1956).

not occur all too suddenly at this particular time. Since the turn of the century, American investments abroad were continuously growing.[44] But after the second world war, the increase of direct private foreign investments assumed tremendous proportion.[45] Following the end of the war up to about 1953, the increase was "greater than all direct investment before 1945, as investment grew from $8 billion in 1945 to $16 billion in 1953."[46] In the period 1950-53, the rate of increase was $1.5 billion a year.[47] Total direct foreign assets of American corporations increased from $11.8 billion in 1950 to $40.6 billion in 1963, or 244 per cent within 13 years.[48] Logically, the instruments of foreign economic policy have to be re-fashioned to suit the newly-crystallized demands of capital export, without however abandoning their usefulness to international trade. These policy instruments operate mainly on two thrusts, namely, the opening of broader channels for fresh investments and the creation of security for property rights of investors — thus defining the focal issues of recent developments in international law. Since the end of the second world war, we have witnessed a concerted effort to formulate the juridical basis in support of the world-wide claims of capital-exporting countries.[49] Such an effort has now turned its emphasis upon "the problem of legal security" for foreign investment in under-developed regions, especially in those countries which have shaken off their colonial status and have followed the course of political and economic independence.[50]

To summarize, the tax-treaty pattern of the United States shows a shift of emphasis (a) from export trade to direct foreign investment, and (b) from developed countries to the under-developed nations.

U.S. Tax Policy Toward Under-developed Countries

Encouragement of private foreign investments has been the constant

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[44] See BARLOW & WENDER, FOREIGN INVESTMENT AND TAXATION 16 (1955).

[45] See HOROWITZ, THE FREE WORLD COLOSSUS, A CRITIQUE OF AMERICAN FOREIGN POLICY IN THE COLD WAR 87 (1965); O'Connor, *United States Taxation of Earnings of American-controlled Foreign Operations,* 42 TAXES 588 (1964).

[46] BARLOW & WENDER, *supra* note 44. at 11.

[47] *Ibid.*

[48] See HOROWITZ, *supra* note 45, at note 1.

[49] See Gardner, *Legal-Economic Problems of International Trade,* 61 COLUM. L. REV. 313 (1961); Fatouros, *The Quest for Legal Security of Foreign Investments — Latest Developments,* 17 RUTGERS L. REV. 257, 275 (1963). See also Metzger, *Multilateral Conventions for the Protection of Private Foreign Investment,* 9 J. PUB. L. 133 (1960).

[50] See Friedmann, *Foreign Investment Planning and Economic Development,* 17 RUTGERS L. REV. 251, 255-256 (1963).

element in post-war foreign policy of the United States.[51] An important part of this incentive policy is calculated to remove or minimize tax barriers to investment opportunities.[52]

Dictated by greater prospect of profits in under-developed regions,[53] American corporations in the last two decades have accelerated their drive into the rich reservoir of raw materials and the sales possibilities in Asia and Africa.[54] Under the cover of the rhetoric of "economic development" of under-developed countries, market strongholds are established, spheres of investment demarcated, and profits pumped out at the rate much higher than the domestic earnings.[55] Accordingly, the U.S. investment incentive policy has veered toward this new direction of opportunism.[56] However, in the tax field at least, the movement to break down barriers to investments has suffered a slack: the tax convention as the traditional vehicle for this purpose among the highly developed countries is generally unacceptable to under-developed economies. The convention rules, as we have explained, are premised on the experience of developed countries growing out of a particular level of development which they share; the balance of interests which defines the reciprocal character of the tax convention precisely rests on this fact. Admittedly, the application of the convention rules in the relationship of a highly

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[51] BARLOW & WENDER, *supra* note 44, at xvii, 78-90; ADVISORY COMMITTEE ON PRIVATE ENTERPRISE IN FOREIGN AID, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT REPORT ON FOREIGN AID THROUGH PRIVATE INITIATIVE (1965).

[52] "I recommend that the taxation of income from foreign business investments be modified in several respects. The investment climate and business environment abroad are much more important than our tax laws . . . Our tax laws should contain no penalties against United States investment abroad, and within reasonable limits should encourage private investment which should supplant Government economic aid". Budget Message of the U.S. President (1954), Tax Recommendations, item 22, quoted in Sugarman, *Current Issues in Taxation Abroad,* 17 OHIO STATE L.J. 277, 285 (1956). See also *Note, Tax Incentives to Investment Abroad,* 8 STAN. L. REV. 77-78, notes 2-6 (1955).

[53] See Diamond, *Economic Problems of Foreign Trade and Investment in Underdeveloped Countries,* 17 OHIO STATE L.J. 254, 257 (1956); Coudert & Lans, *Direct Investment in Underdeveloped Countries: Some Practical Problems,* 11 LAW & CONTEMP. PROB. 741, 746 (1946). See also Block & Heilemann, *International Tax Relations,* 55 Yale L.J. 1159, 1161 (1946).

[54] See Gardner, *The United States and the Developing Nations in* MCDANIELS (ed.), INTERATIONAL FINANCING AND INVESTMENT 58 (1964); Report, *For New Opportunities: Now, the Word is 'Go Abroad',* U.S. News & World Report, June 1, 1964.

[55] See Morray, *Aid Without Tears: Opportunism in Foreign Development Policy,* 46 CALIF. L. REV. 663, 685 (1958); Diamond, *supra,* note 44, at 257-258; BARAN & SWEEZY, MONOPOLY CAPITAL 193-200 (1966); Magdoff, *Economic Aspects of U.S. Imperialism,* 18 MONTHLY REVIEW, 10, 21, 39-41 (1966).

[56] See Meier, *Legal-Economic Problems of Private Foreign Investment in Developing Countries,* 33 U. CHI L. REV. 463, 466 (1965); Rothkopf, *supra* note 20, at 95; Morray, *supra* note 55; Surrey, *The United States Tax System and International Tax Relationships,* 43 TAXES 6-7 (1965).

developed economy and an under-developed country necessarily involves gross inequality against the latter.[57] This relationship is basically defined by the fact that the flow of trade and investment primarily runs in one direction, i.e., into the under-developed country, and that the greater part of income subject to double taxation have their source in that country,[58] Therefore, the effects of tax convention in terms of surrender of jurisdiction, exemption, reduction of tax rate, incentives to entry of capital and commodity, and the consequent relinquishment of tax revenues operate only upon the under-developed country. Under these conditions, paper reciprocity turns into exploitation in practice: profits for one party and revenue loss for the other. Not only that reciprocity is absent. In the first place, the basic concern of the tax convention, namely, international double taxation, should bear an entirely different significance to the under-developed economy. As explained above, double taxation is a problem to the developed economy because it forms a barrier to the outflow of capital. In the under-developed economy, on the other hand, the problem is precisely not the export of capital but the prevention of capital flight. In both cases, double taxation works as a deterrent to capital outflow. But while this effect creates a problem in the case of the developed economy, it operates to the benefit of the under-developed economy.[59] Broadly, this should suggest that the tax convention could not be relied on as a solution common to both types of economy in relation to the same situation, e.g., international double taxation, for the reason that such situation assumes a different quality of relevance in each level of economic development.

Thus, reciprocity seems to be out of the question as the basis of negotiating a tax treaty with an under-developed country. The inducement has to take another form: "the emphasis has shifted from mutual

[57] See Rothkopf, *supra*, note 20; Slowinski, *supra* note 40 at 135; Surrey, *supra*, note 56 at 18: NWOGUGU, THE LEGAL PROBLEMS OF FOREIGN INVESTMENT IN DEVELOPING COUNTRIES 49 (1965).

[58] See Kust *Tax Treaties with Underindustrialized Countries* in SHAW (ed), LEGAL PROBLEMS OF INTERNATIONAL TRADE AND INVESTMENT, 197, 209 (1962); Block & Heilemann, *supra* note 53, at 1166; Surrey, *supra* note 56, at 11-12.

[59] "Double taxation sets up, first, a tendency for new investment to be restricted to capital available within the borders of the country itself. It acts like a tariff for concentrating manufacture within the country... It sets up a tendency for old investment to change ownership from foreigners to [home] investors..." Report on Double Taxation submitted to the Financial Committee of the League of Nations (1923), quoted in Wang, *supra* note 14, at 153.

Indeed, the problem of the Philippines is not how to export capital, but to prevent the outflow of capital: "Movements of private capital were also very adverse. The outflow of private capital in 1964 was about the highest in recent times; while in the first half of 1965, it was at a still higher rate." UNITED NATIONS, ECONOMIC SURVEY OF ASIA AND THE FAR EAST 1965 257 (1966).

benefits to a declared intention of the rich countries to assist in the economic growth of poor countries."[60] The idea here is that the conclusion of a tax convention is worth the sacrifice on the part of an under-developed country because, thereby, foreign capital would flow in to provide the much needed capital for its economic development. The vehicle of this "assistance" is private foreign investment. This leads us to two questions. What is the rationale of the American offensive in terms of direct foreign investiment? Does foreign investment "assist in the economic growth of poor countries"? The answer clarifies the historical premises and contemporary motivation of the new basis of the tax convention with respect to under-developed countries.

Rationale of U.S. Foreign Economic Policy

At the turn of the century, the United States emerged as a world power, creditor in its international relations and expansionist in outlook.[61] At home, it was the age of big business, and "profits from the system were providing sizeable amount of private capital for investment outside the country.[62] For the next half century, the Open Door Policy became the thrust of American diplomacy — "a brilliant strategic stroke which led to the gradual extension of American economic and political power throughout the world."[63] This drive, at various stages, involved aggressive struggle against the business interests of other industrial nations in competition for world markets and spheres of influence.[64] State support of the burgeoning international operations logically extended American sovereignty over foreign territories.[65] In the wake of that grim logic, the Philippines came under the sway of American colonialism. The economic forces which dictated the necessity of that subjugation found clear articulation in the statement of an American senator when he advocated the annexation of the Philippine Islands:

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[60] NWOGUGU, THE LEGAL PROBLEMS OF FOREIGN INVESTMENT IN DEVELOPING COUNTRIES 49 (165).

[61] See WILLIAMS, THE TRAGEDY OF AMERICAN DIPLOMACY chap. 1(1962).

[62] Houghton, *Social Structure and Foreign Policy of the United States,* 15 YEARBOOK OF WORLD AFFAIRS 93, 109 (1961).

[63] WILLIAMS, *supra* note 61, at 38.

[64] See Sklar, *The N.A.M. and Foreign Markets on the Eve of the Spanish-American War,* 23 SCIENCE & SOCIETY 162 (1959).

[65] Woodrow Wilson expressed the spirit of the time when he said in 1907: "Since trade ignores national boundaries and the manufacturer insists on having the world as a market, the flag of his nation must follow him, and the doors of the nations which are closed must be battered down. Concessions obtained by financiers must be safeguarded by ministers of state, even if the sovereignty of unwilling nations be outraged in the process. Colonies must be obtained or planted, in order that no useful corner of the world may be overlooked or left unused." Quoted in WILLIAMS, *supra* note 61, at 66.

We are raising more than we can consume. We are making more than we can use. Today our industrial society is congested; there is more than workers than work; there is more capital than there is investment . . . . Think of the tens of thousands of Americans who will invade mine and field and forest in the Philippines.[66]

The next sixty years saw this rationale asserted with increasing compulsion. Since the end of the last world war, its ramifications have formed the major economic and political developments of the world. A fresh assessment of its meaning drives home the key to the crisis of our time:

To understand the nature of American involvement in the underdeveloped areas of the globe, one must recognize that the economy of the United States differs from that of many other developed countries . . . . In the United States . . . export of capital so far outruns export of commodities as to cause a serious dollar drain. Being primarily a capital-exporting nation, the United States needs market for investment.

Since 1939, the gross national product of the United States has risen steeply, in large part because of the demand for armaments to wage the cold war and to maintain the American universal gendarmerie. A main purpose of this activity has been to keep socialism at bay, and the primary purpose for doing so is that socialist economies are useless to a country relying heavily on capital export . . . .

Meanwhile, our military efforts to keep the world free for American investment generate huge economic surpluses, i.e., capital for investment, because the war-nourished industries at home expand the economic surplus. Thus the very process of protecting the world for American investment creates still greater need for fields in which to invest. The presence of a huge and growing economic surplus makes it absolutely imperative that the world be kept free — for American investment. For that reason we cannot, *under our present system,* ever withdraw our armies from under-developed areas, unless we can arrange for a substitute gendarmerie. Corporation profits have no other place to go because the fields for investment at home grow steadily narrower.[67]

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[66] Albert Beveridge in September, 1898, quoted in WOLFF, LITTLE BROWN BROTHERS 158 (1961). This theme has been restated recently by a well-known commentator on legal problems of international trade and investment: "[T]here are some who remain unconvinced that development aid and private investment abroad are intimately related to our security interests. To such doubters, it must be emphasized that our economic well-being is bound up in maintaining and expanding our position in the world's markets and in developing new sources of raw materials for our expanding industry. Over five million American jobs are directly dependent on foreign trade, and profit margins of many American industries are measured by their income from foreign sources. Our industry is heavily dependent upon foreign sources for raw material, without which our economy could not survive." Proehl, *Foreword, Legal Problems of International Trade,* 1959 U. ILL. L. FORUM xvi-xvii.

[67] Henry, *Capital's Last Frontier,* The Nation 480 (April 25, 1966).

More explicitly, the foreign economic policy of the United States has been formulated around three fundamental goals, namely: (1) to make available foreign raw materials for American industries, (2) to enlarge worldwide market for American products, and (3) to increase utilization of American surplus capital in foreign countries.[68] These goals are more effectively achieved through the instrumentality of direct private foreign investment. Accordingly, the definitive feature of that policy is the encouragement and protection of such mode of doing business abroad.

The function of foreign investment in American economy should be obvious. The expansion of foreign markets, the intensive search for strategic raw materials, and the massive export of surplus capital are all intimately related to the national effort of preventing economic dislocation in general and of maintaining the prosperity of the corporate rich in particular. Unless overseas markets are enlarged, excess production would depress the price below the profitable level, causing reduction in effective demand and unemployment.[69] Dependence of American industries on foreign sources of raw materials has grown critical in the last two decades.[70] The seriousness of the problem has emphasized the military aspect of American foreign policy in the struggle to secure rich sources of strategic materials.[71]

The tremendous accumulation of capital surplus in the United States, as related to its over-saturated capital market, has left no room for the desired investment outlays that would keep pace with the steady increase of accumulation. As the possibilities of investment expansion at home are exhausted, the rate of profit progressively declines. Unless absorbed by an ever-expanding outlets for new investments, the economy would take a downturn. Within the internal structure of American capitalism, even the demands of an expanding population and the creation of new production methods and products have failed to provide sufficient chan-

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[68] See Statement of U.S. Undersecretary of State before the Senate Foreign Relations Committee, January 21, 1959 in ZINNER (ed), DOCUMENTS ON AMERICAN FOREIGN RELATIONS 1959 138-139; BARLOW & WENDER, *supra* note 44, xvii; Proehl, *supra* note 66.

[69] See Proehl, *supra* note 66. See also GALBRAITH, THE GREAT CRASH 1929 chap. x (1963).

[70] The United States is *dependent* on foreign sources to the following extent: 90% cobalt, 96% beryllium, 92% manganese, 100% industrial diamonds, 90% chrome, 100% tin, 84% bauxite, 61% tungsten, 100% natural rubber, 90% antimony, 99% platinum, and 91% nickel. U.S. DEPARTMENT OF STATE, AN ACT FOR INTERNATIONAL DEVELOPMENT, A SUMMARY PRESENTATION 166 (1961), citing 1959 data. See also *Note, Tax Incentives to Investments Abroad,* 8 STAN. L. REV. 77, 70-80 (1955).

[71] See Magdoff, *supra* note 55, at 22-23.

nels for investment surplus. Thus the way out: foreign investment. The problem of surplus has been accentuated by the monopolization of American economy; the increase of capital surplus is accelerated by the control of giant corporations over price and cost mechanisms.[72] It may be true that this problem relates only to the small segment of American business, the financial and industrial oligarchs. But the fact of monopolization precisely involves the whole economic structure in the vicissitudes of monopoly capital. The growing concern of the giant corporations over the prospect of greater profits has become the dominant ingredient of national interest in international trade and investment. In the words of an official of a monopoly firm, "our search for profits places us squarely in line with the national policy of stepping up international trade as a means of strengthening the free world in the Cold War confrontation with Communism."[73] This leads us to inquire into the distinctive thrust of American foreign economic policy: incentive for *private* foreign investment or full state support for the exploitation of profit opportunities in foreign countries.

The overwhelming political and economic power of monopoly capital is suggested by the fact that the 100 largest corporations in the United States own more than half of the total net capital assets.[74] In the field of foreign investment, the concentration of economic power is even more pronounced. Only 45 companies control 57 per cent of the total direct foreign investment of the United States, and more than 80 per cent of all such investment is held by 163 firms.[75] Almost all of the total foreign assets of American corporations in mining is held by 20 companies.[76] Ninety-three per cent of foreign assets in oil is owned by 24 corporations.[77] With the increasing economic power of monopoly, "the federal government becomes more subservient to it, more dependent on it, more disposed to favor it with grants of privilege, protection, and subsidy."[78] One consequence of that power is that American foreign economic policy has been reduced to a function of Big Business in extending the frontiers of capital to the far corners of the globe. We shall now see how this function operates.

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[72] BARAN & SWEEZY, *supra* note 55, at chap. 3.

[73] John D. Lockton, Treasurer of General Electric Company in a speech entitled, "The Creative Power of Profits," April 22, 1964, quoted in Magdoff, *supra* note 55, at 41.

[74] Magdoff, *supra* note 55, at 28, citing *Hearings, Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary,* U.S. Senate, 88th Congress, 2nd Sess., Part I p. 115 (1964).

[75] Magdoff, *supra* note 55, at 20-30, citing *U.S. Business Investments in Foreign Countries,* U.S. Dept. of Commerce, p. 144 (1960).

[76] *Ibid.*

[77] *Ibid.*

[78] ADAMS & GRAY, MONOPOLY IN AMERICA, THE GOVERNMENT AS PROMOTER 1 (1955).

With respect to under-developed countries, state support for the economic out-thrust of American big business comes under "the development assistance program." The professed objective of this program is to assist the economic growth of under-developed countries. Its primary element is that this objective is to be achieved through the instrumentality of American private business.[79] Thus, the strategy of economic development presents two aspects: (1) a wide-ranged incentive (of which the tax convention program is a part) for American foreign investors, in the form of subsidy, protection, and financing; and (2) foreign aid and loan to under-developed countries calculated to develop their economy along private enterprise capitalism, the type of economic organization which would enable these countries to absorb foreign investment.[80]

Promotion of private profit underlies the main instruments of United States foreign development program. A closer examination of their functions leaves no doubt that "economic development" of under-developed countries in fact does not carry any significance other than the development of American corporate fortunes and markets in those regions. To begin with, "our foreign aid programs," said the former president of the World Bank, "constitute a distinct benefit to American business. The three major benefits are: (1) Foreign aid provides a substantial and immediate market for U.S. goods and services. (2) Foreign aid stimulates the development of new overseas markets for U.S. companies. (3) Foreign aid orients national economies toward a free enterprise system in which U.S. firms can prosper."[81] Foreign aid program is specifically designed to finance purchases from the United States.[82] It has been reported that 80 to 90 per cent of U.S. aid funds are spent on American products, contributing 12 per cent of the total U.S. exports.[83] In 1962, AID funds purchased 20 per cent of all U.S. iron and steel mill products,

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[79] See 22 U.S.C.A. sec. 2351, as amended by Pub. L. 89-583, Sept. 19, 1966; Pub. L-87-195, sec. 221, U.S. CODE CONG. & ADM. NEWS 470, 475 (1961); Morray, *supra* note 55.

[80] See U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT & DEPT. OF DEFENSE, PROPOSED MUTUAL DEFENSE AND ASSISTANCE PROGRAMS, FISCAL YEAR 1964 70 (1963). See also conditions under which loans from the Development Loan Fund may be granted, particularly clauses (1) to (9) of Subpar. (6), 22 U.S.C.A. sec. 2161, as amended by Pub. L. 89-583, Sept. 19, 1966; 22 U.S.C.A. sec. 2351.

[81] Eugene R. Black, quoted in Magdoff, *supra* note 55, at 13, citing *The Domestic Dividends of Foreign Aid,* 1 COLUMBIA J. OF WORLD BUSINESS 23 (1965).

[82] See U.S. DEPT. OF STATE, AN ACT FOR INTERNATIONAL DEVELOPMENT, A SUMMARY PRESENTATION xx-xxi (1961); U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT & DEPT. OF DEFENSE, PROPOSED MUTUAL DEFENSE AND ASSISTANCE PROGRAMS, FISCAL YEAR 1964 70-1 (1963); COFFIN, WITNESS FOR AID 137 (1964).

[83] See U.S. DEPT. OF STATE, *supra* note 82; HOROWITZ, supra note 45, at 216.

33 per cent of all fertilizers, 25 per cent of all locomotives, and 10 per cent of all trucks and buses shipped abroad.[84] "A slash in the aid funds," an AID official disclosed, "will slash U.S. export over 80 percent... This means that a cut of $1 billion will cut exports by $800 million."[85] Credit from the Export-Import Bank is extended to foreign buyers of U.S. products. As a general rule, such credit is extended only to finance purchases of goods manufactured or produced in the United States, making the Bank "the servant of United States exporter interests."[86] The disposal abroad of surplus agricultural commodities is given priority under the Agricultural Trade Development and Assistance Act of 1954.[87] The purpose of this program is to open new and expanded markets for American agricultural products.[88] Proceeds from the sale abroad of such surplus are used for projects in foreign countries aimed at increasing the demand for such products,[89] but no loan is allowed which would promote competition with American agricultural products.[90]

The operations of the Development Loan Fund are calculated to develop the free enterprise system in under-developed countries and to prepare their economy for investment of private capital.[91] The development program of the Fund includes "the creation of those basic public facilities on which private enterprise depends. Without facilities such as roads, power and communications, the manufacturing and extractive industries cannot function."[92] Priority is given to projects which facilitate the conversion of profits to dollars.[93] The International Bank for Reconstruction and Development, controlled by American interest, has concentrated its resources to create opportunities for private investment in under-developed countries.[94] Through conditions it provides in loan

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[84] COFFIN, WITNESS FOR AID 28 (1964).

[85] COFFIN, *supra* note 84, at 137. Mr. Coffin has served the U.S. Agency for International Development as Deputy Administrator.

"If exports financed by U.S. foreign aid are separated from commercial exports... the genuine commercial surplus virtually disappears." First National City Bank of New York, *Monthly Economic Letter* 33 (March, 1967), citing 1958-1966 figures of U.S. foreign trade.

[86] Morray, *Aid Without Fears: Opportunism in Foreign Development Policy*, 46 CALIF. L. REV. 663, 670 (1958).

[87] 7 U.S.C.A. secs. 1691-1736.

[88] See 7 U.S.C.A. sec. 1691; Morray, *supra* note 86, at 677-679.

[89] See 7 U.S.C.A. sec. 1704, particularly subsecs. (a) and (e).

[90] 7 U.S.C.A. sec. 1704, subsec. (e).

[91] See 22 U.S.C.A. sec. 2161, as amended by Pub. L. 89-583, Sept. 19, 1966; Morray, *supra* note 86, at 672.

[92] U.S. PRESIDENT'S THIRTEENTH SEMIANNUAL REPORT ON THE MUTUAL SECURITY PROGRAM 19 (1958), quoted in Morray, *supra* 86, at 672.

[93] See Morray, *supra* note 86, at 673.

[94] *Id.*, at 692-693.

agreements, the Bank has induced the government of these countries to give incentives to foreign investors.[95] Its loaning activities in the Philippines, for example, have been limited to the development of the basic facilities necessary to enable the country to absorb private capital investment.[96] Another American controlled financial organization is the International Finance Corporation which has been established "to further economic development by encouraging the growth of productive resources in member countries, particularly in the less developed areas."[97] The Corporation makes supplementary investment capital to private investors and helps to create conditions conducive to the flow of private capital.[98] It invests only in association with private capital.[99] Thus, the allocation of its resources is essentially biased against government participation in industry. A fresh reiteration of American policy for the protection of opportunities for private profit is President Kennedy's indorsement of the recommendation of his Committee to Strengthen the Security of the Free World, that foreign aid should not be extended to help establish "government-owned industries and commercial enterprises which compete with existing private enterprises."[100]

The United States maintains an investment guarantee program for its citizens and business enterprises "substantially beneficially-owned by United States citizens." Under this program it acts as insurer of losses suffered by the American investor in a foreign country due to non-convertibility of profit and capital, expropriation, and war."[101] As the fees paid by the insured investor for the protective coverage are very low relative to the amount of the guarantee, "the risk is thus being borne by the American people rather than by the business interests assured."[102] After the United States has paid the claim of the investor, it is subrogated to whatever right the investor has against the foreign government con-

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95 *Id.*, at 93.

96 E.g., water facilities, electric power and agricultural education development — "social overheads" without which private investment, particularly in manufacturing, extractive and processing industries, will not thrive. See Schacter, *Private Foreign Investment and International Organization*, 45 CORNELL L. Q. 415, 416 (1960); Blough, *Taxation of Income from Foreign Sources* in BITTKER & EBB, TAXATION OF FOREIGN INCOME, CASES AND MATERIALS 16, 20 (1960); Snyder, *Protection of Private Foreign Investment: Examination and Appraisal*, 10 INT'L. & COMP. L. Q. 469, 472 (1961); Proehl, *supra* note 66, at xvii. Thus, the IBRD loans to the National Power Corporation, the National Water and Sewerage Authority, and the College of Agriculture of the University of the Philippines.

97 Articles of Agreement of the Corporation, art. I, T.I.A.S. No. 3260 (1956).

98 *Ibid.*

99 See Morray, *supra* note 6, at 696

100 HOROWITZ, THE FREE WORLD COLOSSUS, A CRITIQUE OF AMERICAN FOREIGN POLICY IN THE COLD WAR 216 (1965).

101 This "insurance business" has been instituted to encouraged U.S. private investment in under-developed countries. See 22 U.S.C.A. secs. 2181-2184, as amended by Pub. L. 89-583, Pt. I, sec. 104(a)., Sept. 19, 1966.

102 Morray, *supra* note 86, at 684.

cerned.[103] As in the case of the Philippines, this arrangement is recognized by the other country through a bilateral guarantee agreement.[104]

This policy of opportunism, as the American foreign development program has been aptly called,[105] is the more emphasized by the efforts of the United States in blocking attempts of under-developed nations to attain economic growth independently of American business interests. It has strongly opposed the establishment of a Special United Nations Fund for Economic Development (SUNFED) sought by the under-developed countries since 1946.[106] Instead, upon its proposal, the General Assembly approved a Special Projects Fund to be used for financial surveys of natural resources, industrial and agricultural research projects, and technological institutes.[107] This, from the American viewpoint, will promote private investment.[108] The same pattern of deliberate frustration has characterized American attitude toward the work of the Economic Commission for Asia and the Far East (ECAFE). As the Executive Secretary of the Commission made clear,

> The United States was equally unsympathetic and aloof, and its policy was no less negative. The United States along with the U.K. was bent upon keeping ECAFE activities confined merely to research and study and was against giving it any major tasks involving active assistance to the countries of the region. They tried to outline a programme of work for ECAFE which involved the Secretariat in studies, economic surveys and technical documentation. They resisted every effort made by the Executive Secretary to establish subsidiary bodies consisting of representatives of member Governments to identify their urgent problems and to see in what ways their mutual efforts might reinforce each other.[109]

[103] For example, the Philippines-United States agreement on the matter states: That if the Government of the United States of America makes payment in United States dollars to any person under any such quaranty, the Government of the Philippines will recognize the transfer to the United States of America of any right, title or interest of such person in assets, currency, credits, or other property on account of which such payment was made and subrogation of the United States of America to any claim or cause of action of such person arising in connection therewith..." *Exchange of Notes Constituting Agreement between the United States of America and the Republic of the Philippines Relating to Guarantees Under Section 111 (b) (3) of the Economic Cooperation Act of 1948*, Washington, February 18 and 19, 1952, 177 U.N.T.S. 307, as modified by Agreement of October 14, 1954 and January 19, 1955, 241 U.N.T.S. 514 and by Agreement of December 12, 1955 and February 18, 1958, 303 U.N.T.S. 336.

[104] U.S. investment guarantees are available in more than 55 countries, as of December 6, 1963. See Armstrong, *The United States Government's Investment Guaranty Program*, 20 BUS. LAW 27, Appendix (1964).

[105] Morray, *supra* note 86.

[106] *Id.*, at 686.

[107] *Id.*, at note 132.

[108] *Ibid.*

[109] Lokanathan, *Verdict on ECAFE*, Far Eastern Economic Rev. 393 (Nov. 21, 1963).

Economic development in terms of industrialization — which would enable under-developed countries to utilize their natural resources in their own factories and to do manufacturing for their own commodity requirements — is particularly anathema to the United States, for reasons based on the rationale of its foreign economic policy we have discussed above. Thus, in the ECAFE the United States has opposed the establishment of heavy industry in Asia, contending that this is not necessary for economic development.[110]

The performance of the United States in the United Nations Conference on Trade and Development (UNCTAD) has demonstrated its unwillingness to contribute to the economic growth of under-developed nations, except in terms of its self-interest. The Conference disclosed the conflict between American foreign economic policy and the desire of the peoples of the under-developed countries to achieve social and economic progress founded upon the principle of sovereign equality of states, self-determination of peoples, non-interference in the internal affairs of other countries, and non-discrimination as to differences in socio-economic systems.[112]

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110 WIGHTMAN, TOWARD ECONOMIC COOPERATION IN ASIA 113-114 (1963).

111 "[The Conference] was significant, not because of immediate achievements, which could only be meagre, but because 75 developing countries joined in securing general recognition of their fundamental need for a reshaping of world trade so as to make it... a broad avenue along which poorer countries might advance towards progressive economic development." UNITED NATIONS, ECONOMIC SURVEY FOR ASIA AND THE FAR EAST 1964 214 (1965). In their final joint declaration, "the group of 75" (which later increased to 77) developing countries stressed the fact that their unity, based on common interests, was the most important aspect of the Conference. The Conference adopted 15 general and 12 special principles "to govern international trade relations and trade policies conducive to development." UNITED NATIONS, PROCEEDINGS OF THE UNITED NATIONS CONFERENCE ON TRADE AND REPORT 18 (1964). On the basis of voting on these principles, the United States showed the most negative attitude towards economic development of underdeveloped countries. It voted against 9 general principles and abstained on 2. It rejected 4 special principles and abstained on 5. On 4 general principles, the United States cast the lone dissenting vote. The Philippines voted in favor of all principles, together with the overwhelming majority of the under-developed countries of Asia, Africa, and Latin America. See division of votes in UNITED NATIONS PROCEEDINGS, *supra* at 18-25.

112 Among the General Principles rejected by the United States but adopted by the Conference are:

General Principle One

> Economic relations between countries, including trade relations, shall be based on respect for the principle of sovereign equality of states, self-determination of peoples, and non-interference in the internal affairs of other countries.

General Principle Two

> There shall be no discrimination on the basis of differences in socio-economic systems. Adaptation of trading methods shall be consistent with this principle.

Foreign Investment and Under-developed Nations.

Our discussion of American foreign economic policy should serve to explain the statement of Recto that "foreign investment has become an important function of American capitalism."[113] In relation to that function, an under-developed country necessarily subserves the requirements of American economy: a source of raw materials or primary products, an export market for surplus commodities, and a situs of investment. Considering the dependence of its economy on foreign investment,[114] the United States must, as a matter of extreme necessity, preserve that relationship. It cannot allow the industrialization of underdeveloped regions, as this would remove the very "breathing space" upon which its survival as a world power depends. In the first place, the economic backwardness of under-developed countries is historically explained by the fact that as colonies they had been exploited by Western industrial powers as sources of raw materials and as spheres of investment.[115] The curious paradox presented by American policy is that it prescribes for the economic development of these countries the very mode which created the conditions of their under-development.

From our discussion of the economic imperatives reflected in American policy we should be able to discern the continuity of forces which brought about the colonization of the Philippines at the turn of the century with those which generated the necessity for a tax treaty program on the part of the United States. Significantly, the proposed Philippines-United States tax convention, premised on the policy of attracting American private capital to the Philippines,[116] basically conforms to the co-

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General Principles Three

> Every country has the sovereign right freely to trade with other countries, and freely to dispose of its natural resources in the interest of the economic development and well-being of its own people. UN PROCEEDINGS, *supra* note 111.

The Conference adopted General Principle One by a roll-call vote of 114 to 1, with 2 abstentions. The lone dissenting vote was cast by the United States. General Principle Two was approved by a vote of 96 to 3, with 16 abstentions; United States voted against, with Canada and West Germany. General Principle Three was adapted by a vote of 94 to 4 with 18 abstentions; United States dissented, with Australia, Canada, and United Kingdom. See UN PROCEEDINGS, *supra* not 111.

[113] *A Realistic Economic Policy for the Philippines,* 2 Francisco College L.J. 30, 38-39 (1956).

[114] See Magdoff, *Economic Aspects of U.S. Imperialism,* 18 MONTHLY REVIEW 10, 14-28 (1966).

[115] DOBB, ECONOMIC GROWTH AND UNDERDEVELOPED COUNTRIES 17-18 (1963); BARAN, POLITICAL ECONOMY OF GROWTH (1962). See also Kuznets, FEINSTEIN (ed), TWO WORLDS OF CHANGE, READINGS IN ECONOMIC DEVELOPMENT 1, 7-8 (1964); Baran, *On the Political Economy of Backwardiness* in FEINSTEIN, *op. cit., at* 329.

[116] See JOINT LEGISLATIVE-EXECUTIVE TAX COMMISSION SIXTH ANN. REP. 1964 48-50 (1965).

lonial pattern. Thus, the application of its permanent-establishment concept would enable American manufacturers to explore or expand their market in this country without the burden of income taxation.[117] In effect, extraction of raw materials is given tax premium in that the Treaty grants non-resident American corporations the privilege to compute the tax "on royalties in respect of the operation of mines, quarries, or other natural resources" not on *gross* income as required under Section 24(b) of the Tax Code, but on *net* basis.[118] A take-over by American interest of substantially all of the stock of a Philippine corporation is relieved of the capital gains tax.[119] As pointed out in the first part of this paper, the tax-free transfer under Article 12 of the Treaty is particularly important where the property exchanged by the American corporation is in the form of patent, copyright, or industrial formula. In many cases, the contribution of the American parent firm in the establishment of a foreign affiliate company takes such form. Hence, this privilege is in fact a tax incentive for American corporations to establish subsidiaries in the Philippines — some kind of a prize for economic penetration. The tax credit system, the expanded concept of nondiscrimination, and the commercial-travelers clause all belong to the broad range of incentives designed to improve the Philippines as a situs of foreign investments.

It has been estimated that in terms of private investment from Western capital-exporting countries, about $2 billion flows into the underdeveloped nations every year.[120] In addition, public aid from the same source goes to these nations at the rate of $2.4 billion a year.[121] Despite, a UN official found reason to emphasize that "at the current level, investment can do little more than keep [under-developed] countries from slipping backward."[122] In Latin America, the average growth rate has deteriorated notwithstanding the net inflow of $8 billion in foreign capital between 1955 and 1961.[123]

The explanation of this lies in the fact that foreign investment is "a method of pumping surplus out of underdeveloped areas, not as channel through which surplus is directed into them."[124] Thus, during the period

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[117] See arts. 7 and 8. Also Gordon, *The Role of Tax Treaties*, 43 TAXES 463 (1963); King, *Tax Convention in* BITTKER & EBB, TAXATION OF FOREIGN INCOME CASES AND MATERIALS 357, 360 (1960).

[118] See art. 11.

[119] See art. 12.

[120] Snyder, *Protection of Private Foreign Investment: Examination and Appraisal*, 10 INT'L. & COMP. L. Q. 469, 471 (1961).

[121] *Ibid.*

[122] Paul G. Hoffman, Managing Director of Special United Nations Fund for Economic Development, quoted in Snyder, *supra* note 120.

[123] HOROWITZ, *supra* note 100, at 219.

[124] BARAN & SWEEZY, MONOPOLY CAPITAL 105 (1966).

1870-1913 Great Britain's net capital export amounted to £2.4 billion, while its income from foreign investments totaled £4.1 billion.[125] In the year between 1950 and 1963, the net direct investment capital outflow from the United States was $17.4 billion as compared to its direct investment income of $29.4 billion.[126] Stated more graphically, "US private investments in the underdeveloped world ... acted as suction pumps, depriving the capital-starved economies of these countries of precisely that essential component of growth, which economic aid programs ... were supposed to supply."[127] Appropriately enough, the American policy on foreign investment has been called "the policy of the suction pumps."[128]

In return for its contribution to "the employment and national income of the nation supplying the foreign investment" and the loss of its "irreplaceable minerals,"[129] the under-developed country only gains "some employment and some tax revenue."[130] Under the tax convention with the United States, the Philippines proposes to give up even "some tax revenue."

From all these considerations, it is plain that the genuine interest of the under-developed economy finds no basis in the tax convention as rooted in the experience of the developed countries: reciprocity is an illusion and "assistance for economic development" is pure blandishment.

III. Some Theoretical Notes By Way of a Conclusion

The development of tax convention in recent times marks the effort to formulate a world-wide consensus on taxation of foreign business enterprises. It seeks to crystallize some rules upon which foreign investors may found a reasonably stable base wherever may be the situs of overseas investment. This effort, which since the end of the last world war has broadened into a movement, now sees some concrete steps toward an international law. The focus of attention has turned on the underdeveloped areas of the world where, it is recognized, the need for predictability and stability of rules is greatest.

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125 *Ibid.*

126 *Id.*, at 106-107. For 1966 private investment outflow of the United States was about $3 billion, while its foreign investment income was about $6.7 billion; in 1965 investment outflow was $3.5 billion as against $6.3 billion investment income. See First Nat'l. City of New York, *Monthly Economic Letter* 33 (March 1967).

127 HOROWITZ, *supra* note 100, at 233.

128 Kirk, *U.S. in Latin America — Policy of the Suction Pump,* The Nation, October 5, 1957.

129 See Recto, *supra* note 113, at 54.

130 *Ibid.*

The increasing dependence of highly developed capitalist economies on foreign investment as outlet for surplus capital and commodity provides the driving force behind that movement. As economies of this type find reason for being in the profit motive, which culminates its expression in the monopoly power structure, so must foreign investment and, logically, the development of tax convention ultimately trace their explanation to the imperatives of a particular social system so organized.

If the development of tax convention represents international law in the process of formation, it should suggest (1) that in the main law on the international plane basically reflects the interests in international trade and investment and (2) that therefore it subserves the ends of policy in the last analysis. In fine, if they are not indistinguishable, law is intimately related to policy. In this light, international legal order in its present state dissolves into its component policy instruments seeking the protection of private property vested in a foreign country. The "rule of law" as propagated by Western industrial nations must be shorn of its abstract and universalistic trappings and seen in its concrete ideological context as serving the interest of neo-colonial powers in the face of the struggle of the peoples in the under-developed areas of the world to place their destiny, not in the hands of the foreign agents of profit but in their own.

The tax convention and other agreements which seek to facilitate the entry of foreign capital and its protection logically bring the law of the capital-importing country into a crisis. Technologically advanced and financially equipped, private investments from highly developed countries have demonstrated great facility in establishing monopoly strongholds in the vital sectors of the under-developed economy. The political consequences of their economic power, combined with the pressure of the diplomatic support from their own government, impose tremendous influence, if not control, upon the whole direction and structure of the under-developed society. Obviously, this points to a serious need for increased competence on the part of the local government in dealing with foreign investments. But here the anomaly comes to light: for precisely the import of treaties for the encouragement and protection of foreign investments is to remove from the exclusive jurisdiction of the Philippines those matters which pertain to the rights and obligations of foreign investors. Where its sovereign expression must be strongest, the Philippines seems to have chosen to sign away its competence by concluding such treaties. A symptom of this crisis has been indicated by the controversy generated by the ruling of its court on the retail-trade nationalization law in relation to the rights of American corporations under the Laurel-Langley Agreement.

The quest for legal security of foreign investments in under-developed countries has characterized the post-war developments in international law. This finds explanation in the fact that since the end of the last world war, the countries which were the traditional raw material hinterlands and investment spheres of the old industrial powers have cast off their colonial status. Among other changes, the emerging nations have undertaken fundamental reforms in their legal system in the effort to evolve legal principles consistent with their political and economic independence and corresponding to the objective state of their social development. Accordingly, they have insisted that central to the concept of sovereignty is the right to determine for themselves the kind of socio-economic system which would best serve their own interest. Fresh from the ravages of colonial exploitation rooted in private profit, those which enjoy real independence have refused to entrust their destiny to private-enterprise capitalism and organized their economy along the principle of public ownership of industry. This trend has come into direct conflict with the policy of the colonial powers to retain these nations as sources of raw materials and spheres of investment. The emergence of new nations, therefore, involves incalculable risks to capital-exporting countries. Foreign capital controlling the vital sectors of the former colony stands the danger of nationalization. Repatriation of profits may be rigidly controlled. Extractive industries and public utilities may be declared close to foreigners. State agencies may take over the financial industry. All this points to the contraction of the field for foreign investments as colonialism continuously retreats. These considerations should serve to explain why the distinctive thrust of American diplomacy in the under-developed countries is to develop their economy along the line of private-enterprise capitalism. The burden of the treaty program of the United States with respect to its former possession is to maintain as much freedom for American business as in a full-fledged colony. In effect, its network of treaties and executive agreements with the Philippines is calculated to insure the integration of this country into the American economy—in fine, to preserve it as a neo-colony. This is the meaning of the observation that in such an instance the law which governs the relationship between the rich capitalist nation and an under-developed economy operates as an instrument of imperialism.