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International Trade Administration

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Appendix 1: Treaties of Friendship, Commerce and Navigation and Their Treatment of Service Industries

Emily A. Arikaki*

The following excerpt is from a 1981 article reviewing the development and current status of friendship, commerce and navigation (FCN) treaties and their treatment of the service industries. The article itself is based on the author’s survey of the FCN treaties in force between the United States and other nations as of 1981. In December 1985, the author updated the excerpt to reflect the effect on services of the recent, FCN-type program of bilateral investment treaties.—eds.

I. FCN TREATIES: FUNCTION AND OPERATION

The right to establish and operate business firms differs from treaty to treaty, depending largely on the era in which the treaty was concluded and the stage of industrialization of the treaty partner. Although approximately one-third of all U.S. FCN treaties provide for national treatment with respect to the establishment and operation of businesses, service industries such as banking, communications, air transport, and shipping are generally excluded. In addition, some treaties restrict the practice of professions such as accounting and law to parties complying with requirements regarding qualifications, residency, and competence. These restrictions appear to serve public health and safety interests. Although such licensing requirements appear to be reasonable, the United States must be alert to situations where such licensing procedures are used in a clearly discriminatory manner.


Background material for this piece was found in articles appearing over the past 35 years in law journals and books on international trade, law, and finance. A list of FCN treaties currently in force was provided by Linda Mawbry of the State Department Office of Treaty Affairs. Information on the current status of the FCN program was provided by Scott Gudgeon of the State Department’s Legal Division and Charles S. Sullivan, a consultant with the State Department.
The traditional friendship, commerce and navigation treaty was designed to establish a framework within which mutually beneficial economic relations between two countries could take place. The FCN treaty sets forth on a reciprocal basis the terms upon which trade and shipping are conducted, and the rights of individuals and firms from one of the states living, doing business, or owning property within the jurisdiction of the other state.

At the present time, the United States is a party to FCN-type treaties with 43 nations. Although concluded over a span of more than 160 years under widely differing circumstances, all of them deal with the same general subject matter. Yet, their responsiveness to present conditions varies. Postwar FCN treaties, which number 22, differ from older treaties primarily in that they place greater emphasis on the right of establishment and the promotion of private foreign investment as opposed to trade and shipping. The change in emphasis is a reflection of the increased foreign investment activities of U.S. businesses following World War II, as well as the fact that after 1934 the trade promotion aspects of commercial treaties were taken over by the reciprocal trade agreements program. In addition, the General Agreement on Tariffs and Trade became the principal forum for negotiating tariff adjustments and furthering trade promotion objectives after World War II.

Other factors influencing the shape of postwar treaties include the increase in foreign governmental involvement in business and commercial ventures, the increase in nationalization and expropriation of property, and the increase in restrictive business practices. Recent FCN treaties have also been used to address questions relating to freedom of reporting, social security, commercial arbitration, commercial travelers, marine insurance, and restrictive business practices.

The standard of treatment prescribed by FCN treaties is either most-favored-nation treatment or national treatment. Most-favored-nation treatment permits discrimination by each country in favor of its nationals and products, but prohibits treating the nationals and products of another country more favorably than those of the treaty partner. Most-favored-nation treatment is a commonly prescribed standard in trade provisions and is the minimum that Americans trading with treaty partners have a right to expect. The national treatment standard prohibits discrimination by each country between its own citizens and those of the treaty partner. It is a commonly prescribed standard in establishment provisions.

All the national-treatment treaties exempt certain vital activities from the guarantee of national treatment. These include the exploitation of land and other natural resources and activities involving precious metals, fissionable materials, arms, public utilities, and national fisheries. Also excluded are air transport, banking involving depository or fiduciary functions, communications, and shipping. Some also subject the provision of insurance and the practice of law and accounting to special requirements. Those areas exempted from national treat-
ment are subject to the most-favored-nation treatment standard. The following excerpt from article VII of the 1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan is typical of the language of postwar FCN treaties exempting certain industries from the guarantee of national treatment.

1. Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territories of the other Party whether directly or by agent or through the medium of any form of lawful juridical entity.

2. Each party reserves the right to limit the extent to which aliens may within its territories establish, acquire interests in, or carry on public utilities enterprises or enterprises engaged in shipbuilding, air or water transport, banking involving depository or fiduciary functions, or the exploitation of land or natural resources.

3. Nationals and companies of either party, as well as enterprises controlled by such nationals and companies, shall in any event be accorded most-favored-nation treatment with reference to the matters treated in the present Article.

Similar exclusions are present in treaties with the following countries:

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Article</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>1963</td>
<td>article VI</td>
</tr>
<tr>
<td>France</td>
<td>1960</td>
<td>article V</td>
</tr>
<tr>
<td>Germany</td>
<td>1956</td>
<td>article VII</td>
</tr>
<tr>
<td>Israel</td>
<td>1954</td>
<td>article VII</td>
</tr>
<tr>
<td>Korea</td>
<td>1957</td>
<td>article VII</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>1963</td>
<td>article VI</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1957</td>
<td>article VII</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>1956</td>
<td>article VIII</td>
</tr>
<tr>
<td>Thailand</td>
<td>1968</td>
<td>article IV</td>
</tr>
<tr>
<td>Togolese Republic</td>
<td>1967</td>
<td>article V</td>
</tr>
</tbody>
</table>

Such exclusions may stem from the national security concern that aliens, friendly or otherwise, should not control industries that are vital to a country's national interest. Exclusion from the national treatment standard is also frequently enforced when industries are solely owned or heavily subsidized by the government.

Other industries, though given national treatment, invite heavy government regulation. For example, the public interest in the functioning of the banking system distinguishes investment in banking from other kinds of private investments because it implicates the nation's monetary system and the credit structure supporting the economy. Insurance is also highly susceptible to government regulations because of its dual role in capital formation and in safeguarding individual and corporate welfare.
II. TREATMENT OF SERVICE INDUSTRIES AND RESTRICTIONS ON PROFESSIONS

Except where provided, service industries are treated like other businesses. The right to establish and operate businesses differs from treaty to treaty, depending largely on the era in which the treaty was concluded, and on the treaty partner's status as either an industrialized or developing nation. Generally, the postwar FCN treaties allow businesses permitted the right of establishment, the right "to engage in the services of accountants, and other technical experts, executive personnel, attorneys, agents and other specialists of their choice, regardless of the extent to which they may have qualified for the practice of a profession within the territories of the other party." This exception for professionals is made when their services are rendered exclusively for those businesses granted the right of establishment and generally does not apply to private practices which, because they often involve the performance of functions in a public capacity or in the interests of public health and safety, are state-licensed and reserved by law to nationals. The following excerpt from article VIII of the treaty with Japan is illustrative of the restrictions placed on the practice of professionals:

3. Nationals of either Party shall not be barred from practicing the professions within the territories of the other Party merely by reason of their alienage, but they shall be permitted to engage in professional activities therein upon compliance with the requirements regarding qualifications, residence, and competence that are applicable to nationals of such other Party.

Similar language is present in treaties with the following nations:

- Ethiopia (1953, article VI)
- France (1960, article VI)
- Germany (1956, protocol, paragraph 8)
- Iran (1957, article II)
- Thailand (1968, article IV)
- Togolese Republic (1967, article V)

Other treaties which place restrictions on professionals include:

- Belgium (1963, protocol, paragraph 6, all professions)
- Denmark (1961, article VII, all professions)
- Greece (1954, article XII, law, dentistry, and pharmacy)
- the Irish Republic (1950, article VII, law)
- Italy (1949, article I, law)
- Luxembourg (1963, protocol, paragraph 5, all professions)
- Muscat & Oman (1960, article V, all professions)
- Pakistan (1961, protocol, paragraph 5, all professions)
III. THE NECESSITY OF FCN TREATIES

The need for FCN treaties has been questioned in view of the fact that the United States has had fruitful and amicable relations with a number of countries with whom it has not concluded such treaties. It should be noted, however, that the right to enter and carry on business on a non-discriminatory basis would not necessarily accrue to U.S. citizens and corporations in the absence of FCN treaties. Free of the restraints of FCN treaties, countries can control the entry of individuals, corporations, and capital as they see fit. While a number of countries that are not parties to FCN treaties currently permit entry, they are free to change their policies and their laws at any time.

FCN treaties have also been criticized for not providing sufficiently precise rights, remedies, and enforcement powers. Cases which arise attempt a diplomatic resolution, when it can be achieved, rather than resorting to proceedings in the International Court of Justice which usually entail elaborate and expensive trials. State Department officials have conceded that these treaties have not been invoked as much as treaty negotiators had envisioned; nonetheless, FCN treaties have provided basic assurances and mutual understandings on behavior.

Although the FCN program has tapered off, present U.S. policy is one of pursuing treaty arrangements for the encouragement and protection of private foreign investment. This policy is reflected in 601 (a) and (b) of the Foreign Assistance Act, as amended, in particular at 601 (b) which states in part:

In order to encourage and facilitate participation by private enterprise to the maximum extent practicable in achieving any of the purposes of this Act, the President shall. . .(3) accelerate a program of negotiating treaties for commerce and trade, including tax treaties, which shall include provisions to encourage and facilitate the flow of private investment to, and its equitable treatment in, friendly countries and areas participating in programs under the Act.

The business and legal communities as well as Congress have given considerable attention to the recent success of several countries of the Organization for Economic Cooperation and Development in concluding bilateral investment treaties with some 50 developing countries. A 1977 report of the Government Accounting Office (GAO) recommended the initiation of a successor FCN-type treaty program emphasizing the protection of private foreign investment in developing countries. The GAO recommendation was endorsed by the International Chamber of Commerce and the State Department's Public Advisory Committee on Transnational Enterprises.

Since 1981, the United States had completed negotiations on bilateral investment treaties (BITs) with Egypt, Haiti, Morocco, Panama, Senegal, Turkey, and Zaire. These treaties are expected to be sent to the Senate for ratification in 1986. Negotiations on other bilateral investment treaties have been initiated with Antigua, Bangladesh, Burundi, Cameroon, the People's Republic of China, the Ivory Coast, Liberia, Malaysia, Sri Lanka, and Uruguay.
Although BITs are of more limited focus than modern FCNs, they provide a greater degree of clarity and protection of investment. For example, they require a more comprehensive dispute settlement mechanism for problems arising between investors and host countries. As with the post World War II FCNs, the BITs exempt the following service sectors from the standard of national treatment: air transportation, ocean and coastal shipping, custom house brokerage, communications, banking and insurance.

To date, with the exception of the treaty with Panama, the BITs appear to cover the professions provided that requirements regarding qualifications, residency, and competence, are met. Part 1(b) of the United States' model BIT states:

"investment" means every kind of investment in the territory of one Party owned or controlled, directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes:

(v) any right conferred by law or contract, and any licenses and permits pursuant to law [1]

In addition, the BITs typically provide that nationals and companies of either party may engage within the territory of the other party and subject to the employment laws of each party, professionals, technicians, and management personnel of their choice, in order to provide professional, technical, and managerial assistance necessary for the planning and operation of their investment.