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Recommended Citation
Michael W. Gordon, Joint Business Ventures in the Central American Common Market, 21 Vanderbilt Law Review 315 (1968)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol21/iss3/2

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Joint Business Ventures
in the Central American Common Market

Michael Wallace Gordon

Professor Gordon discusses the major tax, labor, and corporate law requirements relevant to the establishment of business enterprises in the Central American Common Market countries. The article is not intended as a detailed analysis of the relevant legal and political problems, but attempts merely to provide a starting point for further examination into the area of United States corporate investment in Central America.

I. INTRODUCTION

A new era of economic development in the world evolved with the signing of the Treaty of Rome in March 1957 which formalized the inception of the European Economic Community. The progressive economic integration of six industrially developed nations has been instrumental in persuading many United States industrial entrepreneurs that integrated world trade ultimately will be beneficial to all participants. The European economic integration has also indicated to United States investors that they may no longer be able to dictate their own terms when investing in foreign countries. Even the developing nations have become more perspicacious in delineating their economic requirements, and they are growing less willing to relinquish control in exchange for investment. Unfortunately however, the potential economic benefits of the European integration were not necessarily encouraging to the developing nations of the Western Hemisphere in their quest for narrowing the apparently ever-expanding gap of inequality.

Considerable encouragement has been given to developing nations in the Western Hemisphere by the economic cooperation among five non-industrial nations which, in December 1960, signed the General

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1. Belgium, France, Italy, Luxembourg, Netherlands, Western Germany.
2. With the inclusion of African Territories of EEC members as Associate Members of the market, speculation by Latin American countries on discriminatory favoritism toward the African Associates for primary products was not entirely without reason. However, the net flow of investment by EEC nations to Latin America has been increasing. See Pan American Union, The Flow of Capital from the European Economic Community to Latin America (1963), and Pan American Union, The Effects of the European Economic Community on the Latin American Economies (1963).
Treaty for Central American Economic Integration. This treaty was the genesis of the Central American Common Market (CACM). It essentially provides for a customs union by establishing free intraregional trade and common external tariffs and eventually for a full common market. The actual realization of a common market is conceivable; however, if ultimate economic integration means harmonization of total interest, i.e., economic, fiscal, monetary, political, social and cultural, then such integration is undoubtedly only a conceptual goal. The customs union is expected to be established by 1970. At that time, the United States, for example, would be able to export goods into one country, pay one duty, and then circulate the goods freely to any of the other countries without any import duties or additional charges. An assembly plant in Costa Rica would be able to import component parts, pay a tariff, and then ship the finished goods to any of the other CACM countries without further tariffs. Such an arrangement would be particularly beneficial to industries requiring markets larger than any individual CACM country can provide.

Prior to the formation of the CACM, Central American countries were stigmatized as “banana republics,” and their overdependence on one or two primary agricultural products caused serious cyclical fluctuations of peace-time recession and war-time prosperity. In 1960, intraregional trade among these five nations amounted to only 32.7 million dollars. By 1965, however, it had increased to 142.2 million dollars, primarily due to a significant expansion of trade in industrial goods. This self-help attitude on the part of the CACM countries has significantly stimulated foreign investment. Private capital investment increased from 17.1 million dollars in 1960 to 130 million dollars in 1965. United States investors, for example, have established oil refineries in Costa Rica, El Salvador, Guatemala and Nicaragua and fertilizer plants in Costa Rica and El Salvador. Such growth has included increasing foreign corporate investment, and the role of law has become more important as the business complexities have multiplied.

4. A common market contemplates, in addition to the attributes of a customs union, free movement of labor and capital and coordination of economic, financial and social policies. It is essentially an area without artificial barriers to the free movement of goods and services.


6. Id.

7. To adopt a Malthusian analogy: As business expands arithmetically, the complexities of the law increase geometrically.
The interested investor must consider the form of business association which will best suit his needs in a CACM country. Several forms of investment are available, including licensing, merging, purchasing a local business, or doing business through a registered agent, branch or subsidiary. By using some type of joint venture, it is possible to undertake each of the above forms of investment with varying degrees of participation by the host nation. The joint venture is a form of association of mutual interest and investment which is becoming increasingly favored by United States investors. While the joint venture should always be considered, the advantages or disadvantages of it should not be the primary determinants in deciding whether to do business in a certain country. Following is a brief survey intended to outline some of the areas for deliberation when initially considering doing business in the CACM and, more particularly, when considering the use of the joint venture in a CACM investment.

II. THE JOINT VENTURE

A. In General

Where constitutional or legislative provisions preclude doing business in any other manner, the joint venture may be mandatory for specific investments. In fact, because of the provisions in each of the CACM countries requiring that a certain percentage of the employment positions go to host country nationals, every branch or subsidiary in the CACM is literally a joint venture. Historically, United States investment in developing economies has been in the extractive, export-oriented industries. This type of industry is frequently attacked as exploitative and is the subject of threats of expropriation. Any large, raw material extracting industry or utility in a developing nation may be subjected to such threats due to the very nature of its operation, notwithstanding the benefits which accrue to the country as a result of the outside investment. The constitutions of the CACM countries exemplify this concern for exploitation by claiming national ownership of the subsoil. On the other hand, small industrial enterprises and companies which supply goods to the local market seem to create little opposition.

8. Such other factors as costs, raw material control, markets, taxation and vertical integration must be weighed.
9. See text accompanying note 19 infra.
In choosing a joint venture, the foreign investor may seek several ends: he may be concerned with protecting an existing market where there are indicia of national concern toward his possible monopolistic control over a market; he may be attempting to avoid costly delays in organizing his own foreign enterprise; he may be attempting to qualify for fiscal incentives; or he may be seeking investment guarantees or loans from the Agency for International Development which presumably favors the joint venture. Further the investor may hope to obtain favorable governmental treatment in the form of tax benefits, protective tariffs, repatriation of capital or transfer of dividends, may need additional capital, or he may look upon the joint venture as a means of attracting scarce local managerial talent.

Some measure of local participation in a business investment may be desirable simply to gain the benefit of local knowledge. Since many of the developing economies are controlled by several families, there is usually a close circle of business entrepreneurs who are extremely influential in the government. Joining with one of these entrepreneurs may be helpful since they may have more favorable access to raw materials, suppliers, customers, bankers and government officials. The investor may feel that the participation of local businessmen will lessen the likelihood of nationalization or expropriation, although Central American history of governmental reversals indicates that such participation will not guarantee security. It may be helpful to be considered a local concern rather than a United States branch when offering a product to the domestic market of the host country. The greater the domestic market, the more local assistance will be necessary; consequently, the greater will be the benefit of some form of joint endeavor. Furthermore, local governmental promotion agencies and industrial banks frequently are limited in their investments to industries in which there is some participation by nationals. Certainly the greater the participation of local capital, the less likely there will be adverse public reaction to purported United States domination and the less likely will local investors be to accuse United States investors of harm allegedly resulting from the superior financial and technical resources of the United States.

Conflicts obviously may arise where participants from two different

14. This occurred to an extreme degree in Cuba subsequent to the overthrow of Fulgencio Batista by Fidel Castro, when many investors discovered their host country partner was in disfavor with the government.
15. La Bolsa de El Salvador, a stock exchange company organized in 1964, is an example of such a lending agency.
nations have joined together in a business investment. For example, the United States investor may wish to withhold dividends to increase surplus for investment in the company while the host company may be interested in a rapid investment return. In many instances, the substantial investment in capital equipment which is initially necessary may preclude immediate investment returns.

A joint venture may actually be a venture which “comprises any form of association which implies collaboration for more than a very transitory period.” However, a joint venture by definition usually involves equity participation by both parties. Equity participation may be in various ratios between the venturers and may be present in any of the various forms of business association. A joint venture may also involve non-equity forms such as technical service contracts and management contracts. Usually, the equity joint venture will include some non-equity participation, whereas the non-equity joint venture is less likely to include equity involvement. Substantially all of the United States investments in Latin America have been United States equity investments. In only some four per cent of these have United States investors been willing to relinquish the majority position.

B. Branch and Subsidiary Operations

A branch operation is a form of investment which does not involve equity participation, although it may have some local participation, or joint venture, features. A United States corporation considering CACM investment must determine whether its operation in the host country should be in the form of a branch or in the form of a subsidiary. Although factors other than the desirability of a joint venture will enter into the choice between a branch or a subsidiary, the joint venture must be considered. Because local capital is seldom needed or used in the formation of a branch office, in contrast to the extent to which local capital is used in organizing a subsidiary, it is understandable that advocates of the joint venture prefer the subsidiary form of investment over the branch.

Tax advantages of the subsidiary as opposed to the branch will undoubtedly be the dominant factor in the initial choice of the form of CACM investment. With the curtailment of the deferral of United States corporation income taxes on Sub-part F income received by

17. Id. at 110.
19. As indicated in text accompanying note 9 supra, each CACM county requires a certain percentage of local employees.
controlled foreign corporations, the advantages of the subsidiary have been, in many instances, substantially reduced.\(^2\)

Several of the CACM countries indicate their preference for a subsidiary by a discriminatory imposition of registration taxes. In Guatemala, for example, a branch is required to pay a 1,000 dollar tax upon commencement of business plus an annual registration tax ranging from 500 to 1,000 dollars, whereas a subsidiary is required to pay only the annual tax at rates ranging from twenty-five to 500 dollars.\(^2\) Although these variations are not sufficiently extreme to call for a decision based solely on registration tax preferences, they do indicate the prevailing CACM favoritism for the subsidiary form.

Although the potential liability of the United States parent company is increased by the use of a foreign branch, this may be avoided by establishing a United States subsidiary with limited assets which purchases from the parent corporation for resale to its own CACM branch. Even though this may be distasteful to businesses in the foreign country which must deal with a corporation of extremely limited assets, apparently this would not affect the host country's preference for a subsidiary.

C. The Non-Equity Joint Venture

As indicated above, a non-equity joint venture may be in the form of contracting for technical services, construction, management or licensing and franchise arrangements. A local firm which desires to expand may have sufficient capital but lack the technical resources for effective expansion; consequently, it must turn to outside assistance for this needed advice. A firm with sufficient capital either to develop a new plant or to expand an existing one may need United States architectural or engineering services to actually construct the facility. Management contracts are frequently used in the resort industry where, for example, the building may be owned by a local investor who turns over its management to a United States hotel management firm. On the other hand, the resort may be owned by a United States investor who contracts with the local country participant to manage the resort. Another form of non-equity joint venture concerns the granting of a franchise to an established foreign firm to produce and market United States products. This form has been used in Latin America in the soft drink, automobile, paint

\(^2\) Special exemptions are provided for investment in developing economies. See E. A. Owens, The Foreign Tax Credit (1961). A thorough consideration of the taxation of income of a subsidiary versus a branch is beyond the scope of this article and, since the choice of a subsidiary raises more issues to be considered than the choice of a branch, more attention will be given to alternatives and legislation affecting the former.

and paper product industries. All of these non-equity forms of joint venture may comprise the entire joint venture, or they may be in addition to an equity participation by the host nation.

D. The Equity Joint Venture

The equity form of the joint venture is certainly the more common form and, as indicated above, more desirable from the standpoint of the CACM nations. In many instances where the local entrepreneur obtains only non-equity technical assistance, the assistance may not be as effective as if he were additionally to receive financial support in the form of operating capital, equipment, or supplies. Financial support could consist of a limited equity participation on the part of the United States investor, management control being retained by the host country. Furthermore, some equity involvement by a United States partner may be helpful in that it is more likely to discourage other United States investors from entering the market.

History indicates that a United States firm is unlikely to accept a minority equity position in an investment.22 When faced with such a prospect, a United States firm is likely to prefer a management contract or licensing agreement, and thus to be satisfied with receiving royalties from the local industry, rather than to be committed to a minority equity interest in a local association. One problem which may arise when both countries are interested in having control of the corporation is the possibility of an evenly divided equity participation and a consequential deadlock when the two parties disagree concerning management policies. However, where a majority United States interest consistently outvotes the minority interest, and thereby causes dissension by the local investors, the use of a fifty-fifty equity division may be a resolution of the problem by which the benefits of cooperation will outweigh the detriments of an occasional stalemate.23

While a limited equity participation will obviously decrease profits, it may have the advantage of reducing the problem of foreign exchange, which may be substantial in a lesser developed region such as the CACM. A sufficiently critical problem of foreign exchange may prompt legislative limitations instituted by the local country on the return of profits, on the repatriation of capital, on the importation of materials from third-party countries, and on the amount of salary received from the company which the United States employee may return to the United States. None of the CACM countries requires that all foreign investments be in the form of joint ventures.24

23. Friedmann & Kalmanoff 154.
24. Such countries as India and Pakistan have very restrictive requirements for all foreign investment.
However, El Salvador does require that at least 51 per cent of the ownership of extractive industries be Salvadorian.

Also of concern to potential investors in the CACM will be such factors as the permissible forms of business association, the constitutions of the particular countries, import regulations, investment incentive legislation, corporate taxation, and the influence and effect of labor laws.

III. Forms of Business Association

Each of the CACM countries recognizes both the corporation and the general partnership as forms of business association. The use of the corporation is increasing as the economies become more industrialized. The “joint venture” as a separate form of association is also acknowledged by the CACM countries, but is not given juridical personality as a separate entity. Although each country generally recognizes the same forms of associations, there are sufficient variations to merit a country-by-country inquiry.

A. Costa Rica

There are four recognized forms of juridical business association in Costa Rica: the general partnership, the limited partnership, the corporation and the limited liability company.

1. General Partnership (Sociedad Colectiva). This form is similar to the general partnership in the United States. Unlimited personal liability, jointly and severally, is placed on all of the partners for obligations of the partnership.

2. Limited Partnership (Sociedad en Comandita). In this form of association, the organization of a general partnership is used, but not all the partners will be liable without limitation; partners (comanditarios) may not take part in the management of the business without subjecting themselves to unlimited liability. This form is closely analogous to our own limited partnership.

3. Corporation (Sociedad Anonima). The Costa Rican corporation is in essential structure similar to United States corporations. The personal liability of the shareholders is limited to their capital contribution. The board of directors must consist of at least five members. In addition to the directors, there must be a manager or administrator who manages the business as prescribed by statutes, the dictates of the board at the time of his appointment, or by custom.

25. Mexico has broad restrictions for foreign holdings, requiring 51% Mexican ownership for agricultural operations, radio broadcasting, television, motion pictures, publishing, advertising, fishing, transportation, production and distribution of soft drinks, and the manufacture of tires.

26. MINISTERIO DE INDUSTRIAS, INVESTOR'S GUIDE TO COSTA RICA 20 (San José 1965).
(4) Limited Liability Company (*Sociedad de Responsabilidades Limitada*). This is essentially a development of the English private company, under which a group of individuals, usually limited to twenty-five, makes capital contributions which comprise the extent of their liability but which are not evidenced by stock certificates. The organization can use a firm name. The minimum amount of capital is usually specified by statute and there may be a requirement for additional contributions in order to establish a reserve fund. Management of the organization may be controlled by one or more of the members or by outsiders.

Foreign corporations organizing subsidiaries in Costa Rica may use any of the above forms. Stock may be owned entirely by foreigners, and there is no requirement that Costa Rican nationals be included on the board of directors.

B. *El Salvador*

*El Salvador* recognizes the general partnership, the limited partnership and the corporation. There are no provisions in the present code for the limited liability company. However, there is a new commercial code presently before the legislature which includes the limited liability company as a permissible form. The three established forms are essentially similar to the permissible forms in Costa Rica.

If a corporation has been granted some special privilege or exemption by the government in its operation, then it may be subject to supervision by government agents, primarily to assure compliance with the conditions of the grant. In addition, a reserve fund must be established consisting of no less than one-twentieth of the net earnings of the corporation. At such time as the reserve fund equals one-tenth of the capitalization, additional contributions to the reserve may be discontinued.

*El Salvador*, like *Costa Rica*, recognizes the "joint venture" (*cuenta en participacion*) as a form of business association. The joint venture is not a juridical entity with respect to third parties; the basis of its organization is merely the agreement between the participants.

A partnership or corporation may be formed as a cooperative (*sociedad cooperativa*) which has a variable minimum capital provision and a minimum participation requirement of at least ten members. The instrument of organization must contain conditions for admission, removal, and exclusion of members, and a declaration of the amount and form of capital.

[28. Id. 9.]
[29. Id. 10.]
Foreign companies may operate in El Salvador either through a subsidiary domiciled there or through a branch, or, without formal organization, through a registered agent. Personal liability is imposed on any representative of a company doing business without prior registration.

C. Honduras

Honduras recognizes the four primary forms of business association as well as the cooperative society and the stock-issuing, limited partnership (sociedad en comandita por acciones). This latter form is an organization of partners with unlimited joint and several liability for company obligations and one or more limited partners liable only for the payment of their shares. This differs from a limited partnership in that it is essentially controlled by corporate legislative provisions. At least one-tenth of the capitalization must be provided by general partners, and the shares may not be transferred without the consent of all the general partners plus a majority of the limited partners.

D. Guatemala

Guatemala also recognizes the four basic forms of association as well as the non-judicial "joint venture." The usual registration procedures are required of foreign corporations doing business in Guatemala.

E. Nicaragua

Nicaragua recognizes the corporation, the limited partnership, the stock-issuing partnership, and the cooperative company. Additionally, Nicaragua recognizes a collective company or partnership (sociedad en nombre colectivo) which is not defined in the Nicaraguan commercial code, but which seems to be similar to the English limited liability company. Their organizational articles must stipulate that the partners' liability is limited by their respective contributions, and the word "limitada" must be added to the firm name. Otherwise, the liability will be that of a general partnership, both joint and several, and unlimited in extent. Temporary commercial "joint ventures" are recognized, but not as separate juridical persons.

There are no limitations in Nicaragua as to equity participation by foreigners in domestic companies. In addition, foreign companies are

32. PAN AMERICAN UNION, STATEMENT OF THE LAWS OF NICARAGUA IN MATTERS AFFECTING BUSINESS 29 (1965).
able to operate in Nicaragua through branches or agencies.

There are no restrictions in any of the five CACM countries which preclude an equity participation in a joint venture by a foreign investor if an authorized form of association is used.\textsuperscript{33} Any limitations or restrictions on foreign ownership either preclude foreign investment or require a certain per cent of local capital.

IV. Constitutions of CACM Countries

The constitutions of the CACM countries are particularly significant because they are of comparatively recent origin and perhaps more fully reflect contemporary thinking than does our United States document.\textsuperscript{34} These constitutions contain a substantial number of economic and social provisions which, in the United States, have been expressed through state and federal legislation rather than by amendments to the Constitution. Considering this substantial inclusion of material in the CACM constitutions which we normally associate with federal or state legislation, a detailed inquiry into the legal requirements and restrictions affecting investment in the CACM countries necessitates an examination of the individual constitutions.

A. Costa Rica

The Costa Rican constitution provides guarantees to workers, including the right to organize. However, foreigners may not exercise direction or authority in unions.\textsuperscript{35} Wages, working conditions and miscellaneous advantages may not favor Costa Rican nationals over foreigners, although where conditions are equal, Costa Rican workers are to be given preference.\textsuperscript{36} Until the supply of skilled Costa Rican industrial workers increases, United States investors should have little difficulty in using United States skilled labor in their CACM plants. However, as the Costa Rican workers become trained to assume more responsible positions, the preclusion against wage discrimination may require the United States investor to pay equal wages to nationals of both countries, or justify the higher wages of the United States workers as an inducement to United States nationals to work in the foreign country. He may even be required to withdraw the United States workers as the Costa Ricans become capable of handling the tasks;\textsuperscript{37} to avoid this, he may be able to reduce the training of Costa

\textsuperscript{33} There may be, however, constitutional preferences for local ownership of small businesses. See text accompanying note 48 infra.

\textsuperscript{34} Of course, political instability in a developing nation may mean that a more recent and encompassing document is less indicative of the prevailing view of that country than an older constitution of a politically stable nation.

\textsuperscript{35} PAN AMERICAN UNION, CONSTITUTION OF THE REPUBLIC OF COSTA RICA OF 1949 art. 60 (as amended 1965) [hereinafter cited as CONSTITUTION OF COSTA RICA].

\textsuperscript{36} Id. art. 68.

\textsuperscript{37} Article 68 seems to require this.
Rican workers in order to preclude their acquiring the skills that displace the United States workers. Such a reduction in training however, may cause local dissatisfaction, and may even be contrary to the interests of the of the investor, who might be able to move the skilled United States workers to new areas of investment once they are replaced by Costa Rican workers.

The constitution precludes private monopolies, although state or municipal monopolies may be established by a vote of two-thirds of the full membership of the national assembly.33 State ownership is constitutionally decreed over hydroelectric power, coal beds, wells and deposits of petroleum, other hydrocarbons, any radioactive minerals, and wireless services.34 The assembly may legislate to permit exploitation of these enterprises by public administration or private parties for limited periods of time.40

B. El Salvador

El Salvador, unlike Costa Rica, has a separate title of the constitution devoted to “The Economic Regime.”41 State ownership is claimed over the subsoil and exploitation concessions must be received from the state by special grant.42 Confiscation of property is prohibited, although expropriation is permitted for “reasons of legally proven public utility or social interest.”43 Fair compensation must be made in advance, unless the expropriation is caused by war or public disaster, is for the purpose of supplying water or electric power, or is for road construction, in which cases payment may be spread over periods up to twenty years.44 A corporation is permitted to hold real property used directly for corporate purposes, although it may not otherwise acquire real property.45 Private monopolies are prohibited generally except where the state or a municipality declares that social interest demands their formation. If the owners of enterprises rendering essential community services fail to abide by the legal provisions “governing their economic and social organization,” then the state may undertake to carry out their administration.46

Recognizing the need for more effective utilization of resources, the state may provide for protection of “associations of an economic

38. Id. art. 46.
39. Id. art. 121 (14) a, b and c.
40. Id.
42. Id. art. 137.
43. Id. art. 138.
44. Id.
45. Id. art. 140.
46. Id. art. 144.
nature" where they are more likely to effectively utilize resources and where their profit distribution is considered "fair." Small industry and trade are to be protected by legislation as being "the patrimony of native-born Salvadorians and Central Americans," a provision recognizing the unification of the region.

Where concessions are granted by the state for establishment of docks, railroads, canals or other material public works, these projects must pass into the ownership of the state within fifty years of completion, without compensation, and in "perfect working condition."

Labor is protected under a series of articles delineating rights with respect to sex, race, creed and nationality, minimum wage, social benefits, maximum hours, holidays, social security, and the right to organize. No constitutional provisions preclude foreign nationals from taking part in union organization. However, only native-born Salvadorians may be members or directors of trade unions. The legislature has the power to regulate labor matters.

C. Guatemala

Guatemala also has a separate title devoted to the economic system, indicating that it is an obligation of the state to achieve full development and to utilize resources effectively to increase the national wealth and the standard of living of Guatemalans. Guatemala claims national ownership over the subsoil, but these lands may be conveyed as determined by law. Legal restrictions for reasons of national interest may be imposed upon industries, although the chief executive of Guatemala is allowed to grant exemptions for periods not exceeding ten years for activities which contribute to Guatemalan development. Monopolies are prohibited, and the state may limit operations which are detrimental to the national economy by prohibiting monopolistic tendencies.

Guatemala also has a chapter devoted to labor, including a provision which, under equal conditions of employment, requires that preferential treatment be granted Guatemalan workers and which permits the establishment of laws requiring minimum proportions

47. Id. art. 145.
48. Id. art. 146.
49. Id. art. 149.
50. Id. arts. 181-85.
51. Id. arts. 191-98.
53. Id. art. 212.
54. Id. art. 216.
55. Id. arts. 220-21.
56. Id. art. 223.
57. Id. ch. 5.
of Guatemalans in any enterprise. Only Guatemalans may serve on the managing board and/or advisory bodies of associations organized by workers and owners for the purpose of economic protection and social betterment. The meaning of this provision is unclear, and it may discourage United States investors from entering into any agreement to associate because, even though they had a majority interest in the industry, they may not be able to have any representation on the board of the association. Intervention "in matters relative to labor organizations" is also limited to Guatemalans, although "intervention" is not clarified.

The chapter on property provides for expropriation for reasons of "collective utility, social benefit or public interest" under procedures established by law and upon payment in advance in cash. Compensation may be delayed where the expropriation is the result of war or other serious disturbance. One of the most stringent constitutional provisions affecting foreign investment in Guatemala is the requirement that at least 51 per cent of the capital of a company must be owned by Guatemalans if the company is to "own or possess real property" within fifteen kilometers of the borders and three kilometers of the coast. This would limit United States investment, within these areas, to some form of joint venture or, quite possibly, it might discourage any investment at all. Individuals benefiting from an increase in the value of their property due to a state project may be taxed in proportion to the benefits derived therefrom.

D. Honduras

The most lengthy and newest of the constitutions is that of Honduras. The Honduran constitution has a chapter devoted to the national economy, which recognizes that economic activities are "fundamentally the function of private enterprise." This is qualified, however, where the state may wish to operate certain basic industries, operations and services. Consequently, the state may enact legislation where such legislative intervention will result in an increase in the national wealth, correct a functional defect in the economy, or guarantee economic benefits for the greatest number of Hondurans.

58. Id. art. 116(17).
59. Id. art. 11(9).
60. Id. art. 116(8).
61. Id. art. 125. There is an additional provision designating the method of appraisal of expropriated property, unique in the five constitutions under consideration.
62. Id. art. 127.
63. Id. art. 132. The law may further regulate this area.
65. Id. art. 251.
66. Id.
The intent of the constitution of Honduras is directed more toward providing for growth than toward specifying particular rights and restrictions.

As in the case of El Salvador, small industry is considered to be a patrimony of Hondurans and is to be protected by law.\textsuperscript{67} This would seem adversely to affect some small-scale industries, such as the manufacture of commodities for domestic consumption, which might require substantial foreign investment in order to achieve the fastest rate of development. Property ownership is restricted, as in Guatemala, and only companies composed \textit{entirely} of Honduran "members" may have any ownership interest in land adjacent to national boundaries and to the shoreline for a width of forty kilometers.\textsuperscript{68} Urban property is excepted.

Expropriation for the purpose of establishing railroads, irrigation canals, transmission and telegraph lines, and other similar works, is compensated for only to the extent of the value of the improvements, unless the law specifically indicates otherwise.\textsuperscript{69}

Under a lengthy section devoted to labor and social welfare,\textsuperscript{70} Honduran workers are to be given preference over foreign workers. The legislature may fix a minimum percentage of Honduran workers employed for enterprises, which limit may not be less than 90 per cent, with specific exceptions also provided by legislation.\textsuperscript{71} The executive branch is given power to change this percentage in the interest of the nation. Additional burdens are placed on industrial enterprises, including the establishment of schools for promoting vocational education of employees' children and providing suitable housing, schools, infirmaries and other "services and attention helpful to the physical and moral well-being of a worker and his family," according to determinants established by law.

E. Nicaragua

The Nicaraguan constitution, although lengthy,\textsuperscript{72} does not contain a separate chapter devoted to the economy. However, under various titles, the constitution does contain many of the provisions contained in the National Economy titles of the other CACM countries' constitutions. Nationalization of enterprises is permitted in the general interest, conditioned upon the prior payment of compensation.\textsuperscript{73} Private

\textsuperscript{67} \textit{Id.} art. 258. So, in addition, is commerce.
\textsuperscript{68} \textit{Id.} art. 101.
\textsuperscript{69} \textit{Id.} art. 100.
\textsuperscript{70} \textit{Id.} arts. 123-46.
\textsuperscript{71} \textit{Id.} art. 132.
\textsuperscript{72} \textit{Pan American Union, Constitution of the Republic of Nicaragua 1950} (as amended 1966).
\textsuperscript{73} \textit{Id.} art. 70.
monopolies are prohibited, but state monopolies are permitted in the national interest. There is no constitutional provision permitting the state to grant a monopoly to a private organization, even of limited duration, such as exists in El Salvador. However, permission may be implied by the provision which prohibits the granting of concessions by the state amounting to the establishment of monopolies over natural resources. Since this is an express prohibition against state-granted monopolies over natural resources, it might be assumed that the state has power to grant monopolies to private individuals or corporations in areas other than natural resources.

As in nearly all of the CACM countries, the subsoil belongs to the state, and exploitation is authorized only where the state participates in the profits. Some exceptions are made, primarily for minerals used in construction.

V. Import Regulations

Two stages are required for the formation of a customs union: (1) the elimination of tariffs between member countries and, (2) the unification of tariffs of the member nations on goods imported from outside countries. The General Treaty provides for free trade of all goods among the five nations with the exception of fifty-six products listed in an appendix. These products were to be incorporated in the free trade system at the end of the fifth year of the treaty signing. To provide for uniform tariffs on imports to all of the CACM nations, the Central American Agreement on Equalization of Import Tariffs was signed in 1959. By 1965, 99 per cent of the product listings contained in the Central American Common Customs Tariff had been made uniform, although those goods excepted therefrom constituted nearly 30 per cent of the earnings of the particular countries. Presumably, nearly all of the remaining goods have been the subject of recently formulated uniform tariffs.

Although in comparison with the old tariffs the new duties are favorable to the CACM countries, they have increased by an average of approximately six per cent. This increase in tariffs has provided some protection to the industries within the CACM which are now producing for the domestic market and displacing imports. How-

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74. Id. art. 87.
75. Id.
76. Id. art. 242.
77. Further exceptions are included in Appendix A to the Treaty. At the present time nearly all of the previously excepted goods have been incorporated under the free trade provision.
78. From 42% to 48%. This is an unweighted average. See Pincus, CENTRAL AMERICAN COMMON MARKET, 78 (A.I.D. 1962); ECONOMIC COMMISSION FOR LATIN AMERICA, REPORT OF THE CENTRAL AMERICAN ECONOMIC COOPERATION COMMITTEE 34 & 78 (U.N. 1964).
ever, as income increases, the demand for the more sophisticated United States products will increase, as will the demand for industrial machinery and other capital equipment needed for continued industrial expansion.

VI. INVESTMENT INCENTIVE LEGISLATION

Each of the CACM countries adopted investment incentive legislation between March, 1958 and January, 1961. These essentially grant tax reductions or exemptions to industries contributing to the economic development of the particular country. Incentives are usually excluded from such industries as mineral, petroleum or natural gas extraction, lumbering, fishing, agriculture or tourism. In 1962, the five nations signed the Central American Agreement on Fiscal Incentives for Industrial Development. This treaty has been ratified by all of the nations with the exception of Honduras, which has asked for permission to grant additional incentives beyond those provided for in the treaty because of its relatively slower development. Once the Agreement has been ratified by Honduras, another step in reducing the competition among the CACM nations for outside investment will have been completed. At present the industrial incentive laws of the individual nations are oriented toward individual nationalistic needs rather than the needs of the CACM region. However, even with final ratification of the Agreement, the individual fiscal incentive laws will remain applicable to assembly industries since these industries are not included in the Agreement. There is a protocol for assembly industries, which, when effective, will further harmonize the remaining variances in the individual laws. This protocol would include a system of incentives for certain assembly industries, with regulations regarding the utilization of parts of regional origin in the assembly plants, and providing for assembly product interchange within the CACM.

The Agreement on Fiscal Incentives, when ratified, will be a most significant step. As in the present individual nation agreements, the Agreement will exempt from its coverage many extractive industries. However, the granting of exemptions to these industries will still be under the control of the individual nations who will have the power to continue individual competition for outside assistance in the extraction of raw materials. Enterprises will be classified in three groups. Group A is comprised of industries producing industrial raw materials and capital goods, and industries manufacturing articles of consumption, containers, or semi-manufactured products using at least 50 per cent

79. A reliable private source has indicated to this writer by letter that Honduras will ratify this treaty very shortly.
80. This protocol is also likely to receive Honduran ratification very soon.
Central American raw materials. Group B includes enterprises producing articles of consumption, containers or semi-manufactured products not included in Group A, enterprises producing goods which give rise to benefits in the balance of payments and which have a high value in the industrial process, and industries using a high proportion of non-Central American raw materials, containers and semi-manufactured products. Group C includes industries which do not satisfy the requirements of Groups A and B, industries which simply assemble, pack, cut or dilute products, and specific industries expressly listed, in an annex to the Agreement. Industries in Groups A and B will be classified further as belonging to “new” or “existing” industries. New industries are those producing articles which are not already produced in the country, or which are produced by rudimentary methods of manufacturing, providing the plant fills an important part in meeting the demand of the country’s market and that it introduces “radically different” technical manufacturing processes which help improve productivity. All other industries will be considered in the group of existing industries.

Industries in Group A which are considered new industries receive the greatest benefits. These benefits can amount to the following: (1) total exemption for ten years from duties and other charges on importation of machinery and equipment; (2) decreasing percentage of exemption from duties on importation of raw materials, semi-manufactured products, and containers over a period of ten years; (3) total tax exemption for five years on the importation of fuels (except gasoline) for industrial process; (4) total tax exemption for eight years on income and profits; and (5) total tax exemption for ten years on assets and net worth. The lowest amount of incentive is given to Class C enterprises, which receive total tax exemptions on the importation of machinery and equipment for a period of three years only.

In addition to a reduction of intra-area competition for outside investment, the Agreement on Fiscal Incentives will encourage the expeditious handling of requests for the above legislative exemptions. Previous to this legislation, a country with a less beneficial incentive program might be more attractive to foreign investors if administrative procedure for obtaining incentive preferences were more efficient.

VII. TAXATION AFFECTING CORPORATIONS

The Central American Common Market will remain a customs union rather than a full common market until the barriers to free movement of goods and services are totally removed. This would require the coordination of tax policies which otherwise give preferential treatment to organizations locating in one country as op-
posed to another. Harmonization is more likely to occur in commodity taxation than in corporate income taxation; therefore, it is important to consider the various tax structures within the CACM.

There is little uniformity in the corporate income taxes among the five nations. The reduction of tariffs in accordance with the original Treaty has resulted in a substantial reduction of federal revenue. Consequently, the various CACM countries have found it necessary to find alternative methods for raising revenue. In addition to the need for restructuring their tax systems to enable accumulation of revenue to cover normal governmental programs, the countries are now introducing social reforms which require additional funds.

Progressive rates of both personal and corporate income taxes are common to all of the countries. Differentiation between personal and corporate rates exists only in El Salvador. The rates in all of the countries are lower than those in the United States, and rate differentiation among the five countries is insufficient to become the basis for the location of a prospective business.

A. Costa Rica

The corporate tax rate in Costa Rica ranges from one per cent on net taxable income up to 3,000 colones, to a rate of 122,980 colones plus 30 per cent of the excess income above 500,000 colones. The full expense of free housing constructed by employers for their workers, plus the expense of such other benefits as clubs, libraries, electrical installations, and housing sewerages, may be amortized over a period of five years and deducted. This is indicative of the desire of CACM nations to encourage prospective investors to initiate projects for the benefits of their employees who lack basic facilities.

Included among the numerous tax deductions, many of which would be familiar to a United States businessman, is a loss carry-over of twenty per cent for five years. Costa Rica permits a deduction of up to fifty per cent of the net income which is applied to investments and capital good used in the industry.

An annual property tax is imposed by the federal government ranging from three-fourths of one per cent on property valued from

81. The European Economic Community has announced their decision to harmonize their commodity taxes, aligning the various taxes now existing in five of the nations with the tax on value added in France. European Economic Community Press Release dated February 10, 1967.
82. There has been no indication that the EEC countries intend to harmonize their corporate income tax structure.
83. The decrease in customs revenues may be attributed to (1) removal of intra-regional trade barriers, (2) lower tariffs for imports from outside of the CACM for certain items of certain countries, and (3) investment incentive legislation enabling the government to offer duty exonerations.
84. One Costa Rican colon equals fifteen cents.
10,001 to 250,000 colones to a tax of 1.05 per cent on property valued in excess of 3,000,000 colones. In addition to the regular income tax, an additional tax of one half of one per cent levied on the net profit of branches of foreign companies indicates that the Costa Rican government prefers subsidiaries to branches.

B. El Salvador

El Salvador is the only CACM country which has different schedules for the personal income tax and the corporate income tax. The tax on corporations domiciled in El Salvador is progressive to a maximum of fifteen per cent. While Costa Rican tax increases by one per cent through thirty different stages, the tax in El Salvador is a four-stage tax ranging from 2.5 per cent on taxable income up to 10,000 colones,86 to the maximum of 8,500 colones plus fifteen per cent of income exceeding 100,000 colones. Undistributed profits are also taxed at a rate of fifteen per cent; however, if the profits are later distributed to stockholders, the tax is returned to the company.87

In addition to the usual corporate deductions, special deductions may be made by the government where the nature of the corporation’s contribution to the national economy is considered particularly favorable. This may amount to a total tax exemption in some cases. A firm which is not domiciled in El Salvador is taxed at 38 per cent, which is substantially higher than the rate for El Salvador companies.88

In addition to the usual deductions and depreciation of fixed assets, El Salvador permits an accelerated depreciation. Furthermore, as in all of the CACM nations except Honduras, certain deductions are permitted for reinvested profits.

El Salvador taxes corporate capital at a progressive rate ranging from .05 to .4 per cent.89

C. Guatemala

The corporate tax rate in Guatemala is progressive, ranging from 5 to 48 per cent.89 In some instances, the tax may be proportionately decreased; for example, an industry using raw materials of which

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85. One Salvadorian colone equals $1.00.
86. The government would, of course, then receive tax revenue on the dividends received by the stockholders.
87. Dividends paid to non-residents are taxable at 38% and income to non-residents at 28%.
88. Corporate capital being defined as essentially assets less liabilities.
more than fifty per cent originate in Guatemala, would usually qualify for the decrease.\footnote{90}

Numerous deductions are available, including depreciation of fixed assets, as well as several deductions for medical aid, medicines, and recreational facilities provided for workers and their families.

To encourage industries to establish their plants outside the Department of Guatemala,\footnote{91} a 20 per cent tax reduction is available on the corporate income. Consequently, for an industry established outside of the Department of Guatemala, and which derives more than fifty per cent of its raw materials from Guatemalan sources, income taxes would be reduced by thirty per cent.

There is no tax on fixed assets or capital, although there is a three per cent real estate tax on assessed evaluations. In addition, a special tax on foreign branches ranges from between 500 quetzal to 1,000 quetzal.\footnote{92}

\section*{D. Honduras}

The tax in Honduras ranges from 3 per cent on 5,000 lempiras\footnote{93} through nine stages to a maximum rate of 283,900 lempiras plus 40 per cent of income in excess of one million lempiras. As in El Salvador, Honduras has an accelerated depreciation schedule. Industries classified as basic under the Industrial Development Law may be able to carry over their losses for no more than three years.

In addition to the usual deductions, a corporation may amortize ten per cent of the value of housing constructed and offered rent-free to workers, and twenty per cent of the value of buildings constructed for the cultural and social benefit of the workers. Honduras is the only CACM country which does not permit a deduction for reinvested profits.

Property taxes for business enterprises range from .02 per cent on values from 1,000 lempiras to 50,000 lempiras, to a tax of 34.8 lempiras plus .15 per cent on property values in excess of 50,000 lempiras.

\section*{E. Nicaragua}

The tax on corporate income in Nicaragua progressively ranges from four per cent on taxable income of 50,000 cordobas, to 96,500 cordobas plus thirty-five per cent on taxable income above 500,000 cordobas.\footnote{94} A two-year loss carryover is permitted, which is somewhat less than that allowed in Costa Rica and Guatemala. Businesses lo-
vated in Managua pay a one per cent tax to the Junta Local for Social Assistance, and similar taxes may be found in other Nicaraguan cities. Additional taxes include a one per cent tax on capital in excess of 10,000 cordobas, as well as a tax of one half of one per cent levied on rural buildings valued in excess of 20,000 cordobas and on urban buildings valued in excess of 30,000 cordobas.

A thorough investigation of the tax structures of each country is an essential step in preparing to do business in the CACM; however, the tax considerations should not become the sole determinant for choosing one country over another.

VIII. LABOR LAWS

Nearly two-thirds of the Central American labor force is occupied in agricultural or related tasks. The labor laws of the CACM countries consequently reflect this great pool of semi-skilled and unskilled laborers, and most of the constitutions have substantial sections devoted to the rights of laborers.

The labor unions involved in relatively skilled endeavors are not particularly strong organizations. They have not attained the craft union power present in the United States since there are numerous non-union laborers eager for jobs if the unions place too much pressure on employers. Union activity is primarily devoted to training members to fill skilled positions. However, it is reasonable to expect that as the industrial economy grows in the CACM, the unions will also grow and will eventually consolidate into larger and more powerful organizations which will turn their energies to economic gains.

A. Costa Rica

The Costa Rican labor code, enacted in 1943, precludes employment of foreigners in excess of ten per cent in a company, and the foreign employees may not receive more than fifteen per cent of the total payroll. This would raise certain problems for managerial personnel were it not for exceptions which permit foreign directors, managers and other supervisory personnel up to a maximum of fifty per cent of the total number employed. Minimum wages are set by the Ministry of Labor, and discrimination by nationality is prohibited. As in all of the other CACM countries, an eight-hour day and a six-day work week are the maximum permitted, although some variations are allowed so long as the total number of hours worked during a week does not exceed forty-eight. In addition to the usual vacations and paid holidays, a company is required to provide a bonus

95. CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION, A GUIDE TO MARKET DATA IN CENTRAL AMERICA 87 (Honduras 1964).
96. Additional hours are permitted at overtime rates.
amounting to a full month's pay each December to every employee. Although the wage levels in Costa Rica are approximately only 1.50 dollars a day for unskilled labor and 3 dollars a day for skilled labor, these rates are still the highest among the CACM countries. Costa Rica adopted a Social Security Program in 1943 requiring employers to contribute between two and one-half and five per cent of the total payroll.

B. El Salvador

El Salvador has the most recent labor code, adopted in 1963. As in Costa Rica, El Salvador requires that ninety per cent of the employees be nationals, and that they receive eighty-five per cent of the payroll. The Ministry of Labor is permitted to reduce the percentage without limitation with respect to skills that are not available in El Salvador. In El Salvador, the December bonus amounts to six days pay for workers employed for more than one but less than three years, twelve days pay for those employed more than three but less than ten years, and fifteen days pay for those employed ten years or more. A forty-eight hour week is the maximum work week without overtime pay, and the wage rates are set by the government according to geographic area and the type of industry. El Salvador's Social Security system requires a contribution from employers of five per cent of the payroll.

C. Guatemala

Guatemala also has a relatively recent labor code, enacted in 1961, which also provides for ninety per cent employment of nationals with eighty-five per cent of the payroll going to these employees. The Guatemalan Ministry of Labor is permitted to reduce each of these percentages up to a maximum of ten per cent for up to five years. The maximum hours are essentially the same as in Costa Rica and El Salvador, with equivalent paid holidays. However, there is no required annual bonus as there is in both Costa Rica and El Salvador. The Social Security system requires a contribution of five per cent of the payroll from employers.

D. Honduras

The same ninety per cent restriction with respect to employment of nationals is provided for in the Honduran labor code, enacted in 1959. There are provisions for exceptions, however, with respect to managers, directors and technicians. The weekly work limit is forty-four hours—less than all of the other CACM countries—but overtime work is permitted. The Social Security system of Honduras, enacted in 1959, also requires a five per cent of payroll contribution from employers.

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97. This is also granted by the government to their employees.
E. Nicaragua

The Nicaraguan labor code of 1945 requires that only seventy-five per cent of the workers be nationals, the lowest statutory percentage of all the CACM countries. The code also provides exception for managers, directors and technicians. Nicaragua has the highest Social Security rate for an employer's contribution—seven and one-half per cent.

IX. Conclusion

The European Economic Community's Treaty of Rome was referred to by Paul Monet as the first great anti-trust law in Europe. This view is undoubtedly predicated on the belief that the Treaty of Rome would break up the large cartels existing in the individual European nations by providing relatively uninhibited competition from other nations. However, this has not proved true since many of the old cartels remain strong. Conversely, other individuals expressed concern about the proposed EEC and feared that giant European cartels might develop. These concerns equally proved to be erroneous.

With respect to the CACM, at least one of the developments has been labeled as monopolistic, that being the agreement which arose from the Integrated Industries Convention of June 1958 providing that industries requiring access to the entire CACM in order to have reasonably profitable expectations should be divided among the CACM countries. Two examples would be the Gïnsa Tire plant in Guatemala and the Caustic Soda and Chlorated Insecticide plant in Nicaragua. This arrangement has been attacked as being monopolistic with the argument that free enterprise should determine what industries will enter the region and where they may locate.

Notwithstanding the above developments the Central American Common Market offers a unique and challenging area for investment in developing economies. No other underdeveloped area of the world has shown such forthright action in terms of self-help. The United States should encourage private investment in the CACM even more than it has done to date. Investment in the form of joint ventures could be encouraged through tax credits for investment using this form. It is hoped that such organizations as the Agency for International Development will continue to encourage the use of the joint venture, and that United States investors will become more aware of the potential benefits to be gained from investment in the developing economies.