

LITHUANIA'S PROPOSED FOREIGN INVESTMENT LAWS: A FREE MARKET CRITIQUE

N. Stephan Kinsella *Jackson & Walker, L.L.P. Houston*

Are foreign investors welcome in Lithuania? The answer to this question depends upon whether Lithuania is willing to protect investors' property rights so that they have an incentive to invest their capital in a risky regime. A government's willingness to protect investors' rights is evidenced, in part, by the contents of its foreign investment laws.

At the time of this writing (Feb. 15, 1994), a Draft Project of "Law on Foreign Capital Investment in the Republic of Lithuania" (hereinafter referred to as the "Draft Law") had failed to pass after being considered by the Lithuanian parliament. Another attempt to have parliament enact the Draft Law is expected.

An examination of the proposed law's provisions, including its deficiencies, may be of interest to Western investors.

Mr. M. Cerniauskas, President of the Association of Lithuanian Chambers of Commerce and Industry, recently contacted Mr. E. Blake Mosher, Chief Executive Officer of Mosher International, Inc., to request Western comments on the Draft Law. Mr. Mosher subsequently contacted me to offer me the chance to comment upon the Draft Law prior to its being voted upon by the Lithuanian parliament. At this writing, the Draft Law is still apparently under consideration by the parliament.

The following analysis is based on the comments I submitted to Mr. Cerniauskas.

The Draft Law

According to Article 1, the purpose of the Draft Law is to "regulate rela-

tions between legal persons registered in the Republic of Lithuania and other foreign states, citizens of other states and stateless persons, making investments of their owned assets in the Republic of Lithuania . . ."

The law also regulates "relations between the State and foreign investors, as well as foreign capital investments during the whole period of their existence."

The law is not intended to regulate "the emergence, transformation and termination of ownership and related legal issues between foreign investor (investors) and legal and natural persons of the Republic of Lithuania . . ." Nor does the Draft Law "regulate relations between citizens of the Republic of Lithuania and those of foreign states, stateless persons or legal persons of other foreign states, participating in the process of privatization of state property."

Thus, the main purpose of the Draft Law is to provide a framework governing investments in Lithuania by foreign investors. This is accomplished by providing what types of investment are permissible (and in which sectors of the economy), and by providing for a licensing system and for investment guarantees.

General Considerations

As a general proposition, Lithuania will be successful in attracting foreign capital investments in proportion to foreign investors' ability to make (and keep) profits by investing there. Protection of investors' property rights is essential to this. The more that private property is protected in Lithuania, the greater an investor's ability to make more long-range future plans, which increases the chances of success and also increases the amount of profits that can be expected.

Additionally, if an investor's property rights are well-protected, he is also more likely to be willing to invest in Lithuania in the first place, since he has more confidence that he will be able to keep any profits he earns. A strong Lithuanian policy of protection of private property will reduce the political risk of doing business in Lithuania, which will increase the amount of profits that can be earned and will decrease the costs of doing business, thereby attracting more investments in Lithuania.

Further, Lithuania gives up nothing at all by strengthening investors' private property rights—except the discretion to expropriate or steal investors' property. But Lithuania will

have to refrain from such expropriations anyway, in order to have a stable and productive market economy and to become successfully industrialized. Thus, it is virtually costless to Lithuania to increase the protections afforded to foreign investors.

With these general considerations in mind, it is clear that the Draft Law should be revised to strengthen as much as possible the protections offered to foreign investors. Following are some of the ways in which this might be done.¹ (The Draft Law is provided in the appendix to this article.) The foreign investment protections discussed below would be equally beneficial to investors in other developing countries, and even in the West.

Analysis

International Commitment— Concessions and Stabilization Clauses

Although the Draft Law purports to give investors certain protections and property rights, there is nothing that would prevent the Lithuanian government from changing this law. If an investor must rely upon the existence of the law to be sure that his property rights will be respected, then his property rights will be uncertain to the extent the government is likely and able to simply revise or abolish the law which gives his property protections. Even if the Draft Law were to state that the government may not pass future laws which violate property rights vested in foreign investors by the current law, in reality a future legislature is always able to change the law.

One way to reduce this problem is to internationalize the protections and promises made by Lithuania concerning the sanctity of investors' property. This may be done, for example, through a treaty, by which a state obligates itself and becomes bound under international law. Although this does not physically prevent the state from breaching the treaty, states are, practically speaking, far more reluctant to breach an international obligation than to merely change one of its own internal laws.

Thus the Bilateral Investment Treaties ("BITs") entered into between some pairs of nations, such as Russia and the United States, offer strong protections for the property rights of foreign investors. Lithuania should therefore be urged to enter into BITs with the U.S. and other Western states.

International law also recognizes the ability of a state to bind itself internationally through individual contracts between the state and foreign investors, sometimes known as concessions, and referred to herein as investor-state contracts. Any investor-state contract should contain an international arbitration clause, which can give jurisdiction to a neutral third party (such as the International Center for the Settlement of Investment Disputes, or ICSID), as well as a so-called "stabilization clause." A stabilization clause would provide that the law in force in Lithuania at a given date—typically, the time the investor-state contract takes effect—is the law that will supplement the terms of the contract, regardless of future legislation, decrees, or regulations issued by the government.

Therefore, all the protections afforded to investors in the Draft Law should be internationalized, to help ensure that these protections cannot be arbitrarily overturned by a future legislature. The Draft Law should include a provision authorizing and requiring the government to issue a form contract or license from the state to the investor, which contains international arbitration and stabilization clauses (to internationalize the license), and which incorporates all the protections embodied in the Draft Law as of the date of issuance of the license. This would extend the protections embodied in the Draft Law into the license, thereby internationalizing and thus strengthening the private property rights afforded in the Draft Law.

Under this system, any time an investor began to invest in Lithuania, he would automatically receive such a license from Lithuania, containing a solemn contractual guarantee from Lithuania to abide by the promises made in its Draft Law, and to not change the internal laws of Lithuania in a way that would diminish the prop-

erty rights guaranteed to the investor. Investors receiving such licenses would be more confident that Lithuania does not intend to expropriate their property or raise taxes to a confiscatory rate.

Investors would also feel that a confiscation of their property would be more unlikely to occur, since this would be a breach of international law by Lithuania, which it would probably be reluctant to do. This would increase Lithuania's attractiveness and stability, would reduce political risks faced by investors, and would thus encourage greater investment into Lithuania.

Expropriation of Investors' Property

Article 6: Foreign Investment Guarantees states that "State authority bodies or governmental bodies shall have no right to encroach upon foreign investments or property of foreign investor." This seems to indicate that an investors' property rights should be respected by the government, which implies that the government will not expropriate or nationalize such property.

However, the next paragraph states "Compensation for the appropriated property shall be paid no later than within three months in invested currency or Lithuanian national currency, if capital of an enterprise was formed by non-monetary (property) contributions, according to the actual market value of the property." This sentence appears to contemplate government appropriation (i.e., expropriation or nationalization) of investors' property.

This apparent inconsistency should be eliminated and the law should be clarified. If no expropriation of private property by the state is to be allowed, the law should not contemplate that it may occur. If, on the other hand, expropriation is to be allowed, it should be limited in scope to only narrow situations, since any encroachment upon investors' property rights will harm Lithuania by making it a less attractive place to invest in.

The Draft Law should be revised to clearly state that the government does not have the right to expropriate an investor's property, nor even the right of eminent domain. Since values are subjective, it is impossible to determine

an "appropriate" amount of compensation to pay an investor for the "value" of the property which is taken.²

However, if it is politically unacceptable to remove the government's power of eminent domain, which is likely, the Draft Law should at least clearly state that, in the event of an expropriation, the full value of the property should be received, which includes the market value of both *lucrum cessans* (future profits lost) and *damnum emergens* (damages).

This "full value" standard will help to protect both the value of the investor's property, as well as the property itself, since the government is less likely to expropriate property, the more compensation it would have to pay for it.

Additionally, the Draft Law should state that investments shall not be expropriated, directly or indirectly (which includes both indirect and "creeping expropriation"), unless the expropriation is: (1) for a public purpose; (2) performed in a nondiscriminatory manner; (3) accompanied by payment of prompt, adequate and effective (i.e., full value) compensation; and (4) in accordance with due process of law.

The Draft Law should also provide that any legal expropriation that complies with these international law requirements must be accompanied by full compensation, as discussed above. Any expropriation not in accordance with these provisions should be deemed an illegal expropriation, and a higher amount of compensation should be awarded—for example, the value of the property taken times three, a treble damages standard often found in anti-trust and other laws. If treble-damages standards are validly used by governments to deter especially egregious private behaviour, it also makes sense to subject governments themselves to similar penalties, to deter them from breaching fundamental international law.

Natural Resources

Article 13: Foreign Capital Investment which is Prohibited without Concession, provides that exploration and exploitation of state owned

natural resources is prohibited without a concession.

As discussed above, any property rights acquired by investors should be protected also through a standard form of license or other form of investor-state contract, which internationalizes Lithuania's promises to respect investors' property rights.

Certainly a concession, if it contains international arbitration and stabilization clauses, performs this function. Therefore, the concession described in this Article should provide, similarly to the suggested license, that the concession will contain international arbitration and stabilization provisions.

Taxation

Article 19: Taxation of Enterprises, should be amended to provide that tax rates shall not be raised higher than the rates in effect at the time the investor began its investment; or, that foreign investors shall never be treated less favorably, i.e., taxed at higher rates, than nationals of Lithuania; or both. The Article should provide that any prohibited increase in taxes includes both direct and indirect tax increases—including the effects of inflation, since price inflation is caused by government expansion of the money supply and is economically equivalent to a tax.

If these guarantees were fortified by the internationalized, routinely-granted license suggested in this paper, investors would be more confident that the taxes in effect currently would not increase and eat away at their profits. This certainty of the ability to earn and retain profits would be an additional incentive for investors to invest in Lithuania.

Moreover, if Lithuania is able to do so, it should eliminate all tariffs and taxes of whatever kind, except perhaps for a modest amount of sales taxes, which could be imposed on foreign investors, with this regime backed by an internationalized promise as discussed above. Lithuania could become a tax haven and the resulting rush of investors to invest in Lithuania could transform its economy virtually overnight.

There is nothing preventing Lithuania, or any other country, for that matter, from doing this, other than anti-capitalistic inertia and ideology.

Article 20: Tax Reliefs and Tariffs, provides for income tax reductions for five and three year periods. These periods should be extended as much as politically feasible, and the percentage reductions on tax rates should be increased as much as politically feasible.

Article 20 also provides that, if an enterprise is voluntarily liquidated during the time when these tax reliefs are in force, or within three years thereafter, the investor must disgorge the "saved" tax reliefs that they received. This provision is one of the worst provisions in the Draft Law. It should definitely be abolished.

It is wrong to think that an enterprise can be made to be profitable by force, threats, or coercion, which is what this law amounts to. This law provides a perverse incentive for companies investing in speculative or risky enterprises to avoid investing in Lithuania, for it effectively increases the potential losses the investor may face.

In order to be successful, businesses must also be allowed to fail when market conditions so dictate. If firms' ability to fail is removed, so is the ability to succeed—just as an individual can only be moral if he is free to choose both the right and wrong course of action.

(This parallel between moral flourishing and flourishing in the market is no coincidence, for the free market, a liberal order under which individuals are free and treated as sovereigns, is the moral economic system.)

Leases on State-Owned Land

Article 14: The Right of Enterprises to Use Land Plots and Real Property provides that State-owned land may be leased for enterprise for up to 99 years. This provision should be amended to allow or even require the government to internationalize any such lease, i.e., to include international arbitration and stabilization clauses in the lease contract to ensure that rights granted to investors-lessees are protected as fully as possible.

Reduce Regulations on Acquisitions of Shares

Article 9: The Right of Acquisition of Shares of Enterprises and Credit Companies requires that foreign investors must procure the consent of the Bank of Lithuania in order to acquire up to 20%, 33%, or 50% of the shares of credit companies. Such regulations are unnecessarily burdensome and costly for investors, and tend to increase the cost of business and thus reduce the incentive for investment in Lithuania.

Such regulations also presume that the investor has in improper purpose, and are thus a form of "prior restraint." However, for law-abiding investors, it should be presumed that the investor has no improper purpose and is attempting to legally and properly make profits by creating wealth. The requirement to obtain the Bank of Lithuania's consent before acquiring varying percentages of shares in credit companies should be deleted or diluted as much as politically feasible.

Legal Monopolies and Other Monopolies

Article 10: License to Make a Foreign Investment or to Participate in Certain Types of Activity requires an investor to obtain a license when investing in certain enterprises holding a monopoly in the Lithuanian market. While a legal monopoly, such as the government's monopoly over the printing of money or the building of roads, is a true monopoly, the concept of a non-legal monopoly has always been a problematic one, and legal systems would be well-served to abolish this concept.³

Typically, "monopoly power" is attributed to any successful company that prospers and grows because it is innovative, efficient, and satisfies its customers' demands. Thus to punish firms for being "monopolies" is to punish success and flourishing. Rather, Lithuania needs to encourage success in order to build a healthy, robust economy. Therefore Article 10 should be amended to require a license only for investments in legal monopolies, if at all.

Prohibited Investments

Article 12: Investment Object wherein Foreign Capital Investment is Prohibited prohibits foreign investments in certain sectors of the economy. Some of these are defensible on sovereignty or national security or defense grounds, such as illegal narcotics and weapons. However, items 5-9—manufacturing of alcoholic beverages; securities, banknotes, coins, and stamps; treating of certain dangerous illnesses; treating animals with certain diseases; and gambling activities—are unduly restrictive.

Each of these activities, as long as they are legal, could benefit from the increased capital, know-how, technology, and competition which would result from allowing foreign investors to invest in these areas. For example, if wine or beer can be made more cheaply or more efficiently or in greater variety due to foreign capital or control, there is no reason to deny Lithuanian citizens the benefits of having greater options to choose from. As the successful history of privatization shows, private enterprises can efficiently perform activities historically monopolized by governments, such as minting of coins. Items 5-9 should therefore be deleted from the list of prohibited investments.

Presumption of Permissiveness of Actions

In the original American constitutional system, it was presumed that all actions by individuals were permissible unless expressly prohibited by government. This is a general presumption of individual liberty, and it is necessary for any successful society and economy. The opposite system that has been implemented in certain countries holds that only actions which are expressly permitted by the government are allowed, while anything else is prohibited. It is essential for businesses that the former system be in place, rather than the latter.

To that end, the Draft Law should contain a provision which provides that, in cases of doubt or ambiguity, or where the Draft Law or other laws are silent, it is presumed that any investment-related activity of a foreign investor is permissible and legal. Thus,

investors would be free to engage in actions not prohibited by the Draft Law. This would increase the certainty of the legality of options open to investors, and would hence broaden their range of legal options, which increases investors' chances at making profits. This, in turn, increases Lithuania's attractiveness as a host country for investment.

Contract Rights as Property Rights

Often it is unclear whether contractual rights are property rights or something related, but different. Because contract rights—for example, accounts receivable—are assets as important to many companies as tangible property like land and buildings, the Draft Law should clearly provide that "property" and "property rights" includes all sorts of rights, including immovables such as land, movables such as office equipment, corporeals and incorporeals, intellectual property rights, and contract rights, all of which are equally protected private property rights.

Conclusion

One of the problems the emerging economies of Eastern Europe face is that too much attention is being paid to the advice of Western governments. Western governments are facing their own problems now, primarily because of too much government interference and regulation in the free market, which, ultimately, is the only creator of wealth.

Eastern Europe should be wary of accepting the advice of Western governments to tax and regulate the market, adopting our IRS, SEC, and anti-trust laws. The soundest critique of Western economic problems has been that explaining why government intervention and the erosion of individual rights, including property rights, has resulted in our recessions and stagnation. If Eastern Europe's nations would learn from the West's successes—which were built on free enterprise and private property—but also from our mistakes—i.e., too much government—they could be well on their way to economic prosperity. The private property-oriented suggestions offered herein can help lead Lithuania towards this goal.

APPENDIX

DRAFT PROJECT: LAW ON
FOREIGN CAPITAL INVESTMENT
IN THE REPUBLIC OF LITHUANIA

Chapter 1

GENERAL PROVISIONS

Article 1. Objective of the Law

This Law shall regulate relations between legal persons registered in the Republic of Lithuania and other foreign states, citizens of other states and stateless persons, making investments of their owned assets in the Republic of Lithuania, as well as relations between the State and foreign investors, as well as foreign capital investments during the whole period of their existence.

The Law shall not regulate the emergence, transformation and termination of ownership and related legal issues between foreign investor (investors) and legal and natural persons of the Republic of Lithuania, with the exception of cases established by this Law.

The provisions of this Law shall not regulate relations between citizens of the Republic of Lithuania and those of foreign states, stateless persons or legal persons of other foreign states, participating in the process of privatization of state property.

Article 2. Definitions

Definitions as used in this Law.

"Objects of Investment" - production, trade, services.

"Entities of Investment" - legal persons, registered in foreign states, who make investments of foreign capital in the Republic of Lithuania, as well as citizens of other states and stateless persons, permanently residing abroad at the moment of making foreign capital investment.

"Foreign Investor (Investors)" - an investment entity whichever pursuant to the procedure established by laws has invested its owned assets in the Republic of Lithuania.

"Foreign Capital" - to an investment entity by the right of ownership, the following assets belonging:

- 1) convertible currency;
 - 2) evaluated in convertible or Lithuanian national currency:
 - a) real estate (buildings, constructions, premises and other real estate), located in the Republic of Lithuania or in other foreign states;
 - b) industrial or intellectual property;
 - c) movable property;
- used to form or increase authorized capital.

"Foreign Capital Investment" - single legal action by which an investment entity puts its owned capital in the Republic of Lithuania.

"Foreign Capital Investments" - investment of investor's capital in production, trade, services provided.

"Enterprise" - a newly established, reorganized or operating enterprise whereto a foreign capital is invested.

"Enterprise Controlled by Foreign Investor (Investors)":

-upon the establishment, reorganization or participation in the operating enterprise the newly emerged right for a foreign investor (investors) to determine character or type of activity of an enterprise or to manage it (by a direct control right);

-by the establishment agreement of an enterprise and bylaws or acts of management bodies of an enterprise the granted right to a representative or representatives of an investor (investors) to determine character and type of activity of an enterprise or to manage it (by indirect control right).

"Investment Dispute" - a dispute between a foreign investor (investors) and the Republic of Lithuania on the amount of compensation for the appropriated property order and conditions of payment.

"Concession" - the compensation agreement for the permission to exploit state owned resources for a period defined in the agreement.

"National Regime" - legal environment whereto legal persons registered in foreign states, citizens of other states and stateless persons at the moment of making investments and within the period of existence of the investment enjoy the very same rights and have the very same responsibilities equal to

those of legal and natural persons of the Republic of Lithuania, with the exceptions of cases established by this Law.

Chapter 2

FOREIGN CAPITAL
INVESTMENT**Article 3. Forms of Foreign Capital Investment**

Investment entities shall enjoy a right, without any restrictions, with the exception of cases established in Article 10 of this Law, to invest their owned capital in the Republic of Lithuania by the following forms:

- 1) establishing an enterprise;
- 2) acquiring securities of operating enterprises;
- 3) establishing a commercial bank or acquiring shares in operating banks.

Legal persons, registered in foreign states, are entitled to open their mission in the Republic of Lithuania, which is not a legal person and may not be involved in economic-commercial activity.

Legal persons, registered in foreign states, are entitled to establish their branches, as well as establish subsidiaries or manage them.

Article 4. National Regime

National Regime shall be applied to investment entities that invest their capital in the Republic of Lithuania.

Investment entities are considered foreign investors from the moment of establishment (registration) of an enterprise or acquiring shares of stock or bonds.

Article 5. Amount of Foreign Capital Investment

Amount of foreign capital investment shall have to be not bellow than one thousand USD or equivalent in other convertible currencies, with the exception of cases set forth by Article 3 of paragraph 1, 2 and 3 subparagraphs.

Article 6. Foreign Investment Guarantees

Foreign investments, investor's profit, income, rights and legal interests in the Republic of Lithuania shall be protected by the State of Lithuania.

State authority bodies or governmental bodies shall have no right to encroach upon foreign investments or property of foreign investor.

Compensation for the appropriated property shall be paid no later than within three months in invested currency or Lithuanian national currency, if capital of an enterprise was formed by non-monetary (property) contributions, according to the actual market value of the property.

Compensation, received for the appropriated property, at the request of investors (investor) shall be transferred abroad without any restrictions.

Foreign investor (investors) in cases of investment disputes shall be entitled to apply directly to the International Centre for Settlement of Investment Disputes (I.C.S.I.D.), with reference to Convention "On Investment Disputes between Countries and Citizens of Other States" norms, adopted in Washington 18 March, 1965.

Article 7. Establishment, Operation and Liquidation of an Enterprise

The procedure of establishment, operation and liquidation of enterprises and their legal status shall be defined according to the law of that type of enterprise.

Enterprises shall be registered by the procedure established by the authorized governmental body.

The procedure of establishment of a commercial bank with foreign or mixed capital shall be defined by the "Law on Commercial (Stock) Banks of the Republic of Lithuania".

Article 8. Formation of Capital of Enterprise

The owned assets of an enterprise shall be formed by monetary and non-monetary (property) contributions, as well as industrial and intellectual property.

Foreign investor shall have to make monetary contribution to the formed owned capital of an enterprise in hard (convertible) currency or in Lithuanian national currency in the manner established by the Government of the Republic of Lithuania.

Upon the agreement of parties, non-monetary (property) or industrial and

intellectual property contributions shall be evaluated in convertible currency or Lithuanian national currency.

Article 9. The Right of Acquisition of Shares of Enterprises and Credit Companies

Investment entity is entitled, without any restrictions, to acquire shares of enterprises and credit companies in all property forms, with the exception of cases set forth in this Article.

Investment entity may acquire only registered shares of state and state stock enterprises.

To acquire shares of state and state stock enterprises of specific destination investment entity may only by obtaining license to make a foreign capital investment by order established in Article 11 of this Law.

To acquire, increase (decrease) the amount of shares of credit companies up to 20%, 33% or 50% of a fixed capital of a bank a prior consent of Bank of Lithuania should be received.

Investment entity may acquire shares of enterprises or credit companies of all types of property for hard (convertible) currency or Lithuanian national currency.

Article 10. License to Make a Foreign Investment or to Participate in Certain Types of Activity

Investment entity shall receive a license to make a foreign investment when:

1) investing in state and state stock enterprises of special destination, the list of which shall be approved by the Government of the Republic of Lithuania;

2) investing in an enterprise, holding a monopoly in the Lithuanian market or may gain a monopoly from the moment of making foreign capital investment.

Article 11. The Procedure of Issuing a License to Make a Foreign Capital Investment

A license to make a foreign capital investment in cases set forth by Article 10 of this Law shall be issued by the Government of the Republic of Lithuania or its authorized body.

Foreign capital investment shall be made no later than six months from the date of the receipt of the license.

If the capital of an enterprise is not formed within the fixed period, the license shall be revoked.

Chapter 3

INVESTMENT OBJECTS
WHEREIN FOREIGN
INVESTMENT IS PROHIBITED
OR LIMITED

Article 12. Investment Object wherein Foreign Capital Investment is Prohibited

Foreign capital investments are prohibited in objects engaged in:

1) economic-commercial activity, related to the security and national defence of the Republic of Lithuania;

2) manufacturing narcotics, narcotic, harmful or poisonous substances;

3) growing, manufacturing and selling cultures, containing narcotic, harmful or poisonous substances;

4) manufacturing and selling weapons and explosives;

5) manufacturing vodka, wine, liqueurs and other alcoholic beverages;

6) manufacturing securities, banknotes and coins, and post stamps;

7) treating persons ill with dangerous and especially dangerous diseases, including venereal diseases and infections, skin diseases and aggressive forms of psychic diseases;

8) treating animals with especially dangerous diseases;

9) establishing or operating gambling houses, organizing games of chances or holding lotteries.

Article 13. Foreign Capital Investment which is Prohibited without Concession

Exploration and exploiting of state owned natural resources is prohibited without a concession.

Article 14. Activity of Enterprises, Controlled by Foreign Investor (Investors)

Enterprises, controlled by foreign investor (investors) shall be prohibited from:

1)operating state owned highways, railways, seaports, airports according to their functional purpose, these objects being of national significance;

2)operating oil and gas pipelines, communications, electric power transmission lines, heating systems, and ensuring technical functioning of these objects.

Chapter 4

THE PROCEDURE OF THE ACTIVITY OF ENTERPRISES

Article 15. The Right of Enterprises to Use Land Plots and Real Property

Enterprises shall have the right to own or rent buildings and premises necessary for their commercial-economic activity, as well as to rent plots of land for the construction of said buildings accordingly to laws of the Republic of Lithuania.

State owned land may be leased for enterprise for up to 99 years, with a right of priority for extension of the lease.

Private land shall be rented according to the agreement of parties.

Article 16. Accounts of Enterprises

Balance sheet and statistical accounting prescribed by laws of the Republic of Lithuania shall be applied to enterprises.

Article 17. Interrelations between Enterprises and Financial and Control Bodies

Control over conformity of the business conducted by enterprises with the laws of the Republic of Lithuania shall be exercised by the bodies of State Control and financial bodies of the Republic of Lithuania.

Upon the demand of the bodies of State Control or financial bodies of the Republic of Lithuania, said enterprises must, within the limits established by the laws of the Republic of Lithuania, submit the necessary information on their activities for review.

Article 18. The Responsibility of State Control Bodies and Officers

The control body must ensure the confidentiality of commercial secrets of enterprises reviewed.

The content of a commercial secret is established by the law.

The control body must compensate enterprise for losses incurred.

Losses are completely compensated from the state budget, if the control body proves it obtains no sufficient means to compensate the enterprise for the losses incurred. The procedure and conditions for compensating losses from the state budget is established by the law.

Officers, having revealed commercial secrets of the reviewed enterprise, shall be prosecuted.

Chapter 5

TAXES AND TAX RELIEFS

Article 19. Taxation of Enterprises

The procedure of taxation of enterprises shall be established by the Tax Law of the Republic of Lithuania.

Article 20. Tax Reliefs and Tariffs

If an enterprise is registered in the Republic of Lithuania, profit (income) tax levied on the share of enterprise's profit or income (proportionate to the share of foreign capital in the owned capital of the enterprise), and also reinvested in the production, shall be reduced by 70% for a 5 year period. On the expiry of the period, profit (income) tax levied on the share of the profit (income) due to the foreign investment shall be reduced by 50% for a 3 year period.

The tax reliefs indicated in the first point of this Article shall be applied from the moment of the receipt of profit.

Other tax reliefs shall be applied according to tax laws and other laws of the Republic of Lithuania.

If an enterprise is liquidated by the consent of founders during the time when tax reliefs are valid or within 3 years since the expiration of tax relief term, it must pay the difference between profit tax and profit tax reliefs when they were valid.

Alternative of Article 20

Profit and income of enterprises, registered in the Republic of Lithuania, is taxable in general manner.

Article 21. Responsibility for Violating Tax Law

Penalties, established in the laws of the Republic of Lithuania, for violating of tax laws shall be applied to enterprises.

Article 22. Disposition of Profit or Dividends, Derived from Foreign Capital Investment

Dividends, profit or a portion of a profit in hard currency of a foreign investor (investors) shall be repatriated or transferred abroad without any restrictions.

Foreign investors may also transfer all or a portion of their profit, dividends in form of products or services acquired on the Lithuanian domestic market, or reinvest said income in the economy of the Republic of Lithuania.

Article 23. Customs Reliefs

Contributions of foreign investors to the owned capital during the period of formation or increasing thereof shall be exempt from custom duties.

If an enterprise is liquidated by the decision of founders, assets or part of property repatriated of foreign investors and property acquired by foreign investors for profit or dividends shall be exempt from customs duties.

Chapter 6

FINAL PROVISIONS

If an international agreement sets other conditions of making a foreign capital investment or existence of the investment than this Law, in that case an international agreement shall be prevailing.

Comments

To ensure effective functioning of this Law, it is necessary to make complex amendments in laws related to the establishment and activity of economic entities. For example, the following amendments shall be made in "Law on

Enterprises of the Republic of Lithuania", as well as in other laws:

-to separate a branch from a legal person;

-to clearly define features of subsidiaries;

-to provide a right to establish an enterprise (legal person) for one founder;

-to draft and adopt a law, in which opportunity to form capital of an enterprise on the basis of general partial property of founders would be determined.

Insurance of Enterprises

The property of enterprises in the Republic of Lithuania must be insured by state or private insurance agencies, regardless of whether same is insured in other localities.

The Procedure of Conducting Financial Operations of Enterprises

Financial operations of enterprises shall be conducted through banks registered in the Republic of Lithuania. Enterprises may open bank accounts in other states as well.

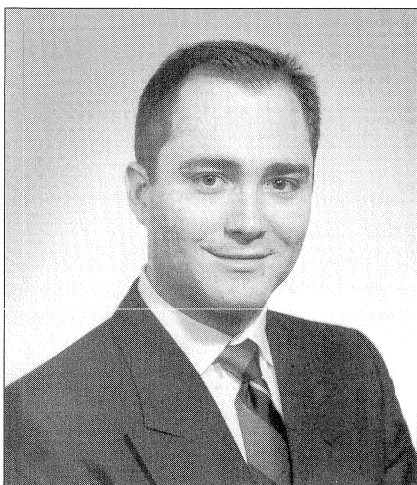
References

1. For further discussion of some of the methods for reducing political risk, and related international law issues, discussed in these comments, see the following articles by Paul E. Comeaux and myself: Reducing the Political Risk of Investing in Russia and Other C.I.S. Republics: International Arbitration and Stabilization Clauses, *Russian Oil & Gas Guide* p. 21 (Vol. 2, No. 2, April 1993); United States Bilateral Investment Treaties with Russia and Other C.I.S. Republics, *Russian Oil & Gas Guide* p. 23 (Vol. 2, No. 3, July 1993); Insurance for U.S. Investments in Russia and Other C.I.S. Republics: MIGA and OPIC, *Russian Oil & Gas Guide* p. 3 (Vol. 2, No. 4, October 1993); Political Risk and Petroleum Investment in Russia, *Currents, International Trade Law Journal* Summer 1993, at 48; and Reducing

Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance, N.Y.L. Sch. J. Int'l & Comp. L. (1994-forthcoming).

2. The views of the Austrian school of economics on the subjective nature of value are extremely insightful. For a classic treatment, see Ludwig von Mises, *Human Action: A Treatise on Economics* (3d. ed. 1966) (1949). See also the further Austrian economics insights contained in Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles* (1962) (two volumes) and Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (1989). For a forthcoming detailed review of Hoppe's latest book, see my article *The Undeniable Morality of Capitalism*, 25 *St. Mary's Law Journal* ____ (Vol. 25, No. 4, June 1994) (review essay of Hans-Hermann Hoppe, *The Economics and Ethics of Private Property* (1993)). To obtain these books, contact the Ludwig von Mises Institute (Auburn University, Auburn, Alabama, 36849, telephone 205/844-2500).
3. See Rothbard, *supra* note 2, at 604-15, discussing "The Illusion of Monopoly Price on the Unhampered Market." See also Chapter 1 of Hoppe, *supra* note 2, "Fallacies of the Public Goods Theory and the Production of Security."

Article No. 9404003



Kinsella

The author . . .

N. Stephan Kinsella is an associate in the energy and intellectual property sections and in the international law practice group in Houston office of Jackson & Walker, L.L.P. He received his B.S. (1987) and M.S. (1990) degrees in Electrical Engineering from Louisiana State University, his J.D. degree (1991) from the Paul M. Hebert Law Center, Louisiana State University, and his LL.M. degree (1992) in International Business Law from King's College London, University of London. He is licensed to practice in the States of Texas and Louisiana, and before the U.S. Patent and Trademark Office. Mr. Kinsella may be contacted at Jackson & Walker, 1100 Louisiana, Suite 4200, Houston, TX 77002. Phone: (713) 752-4360. Fax: (713) 752-4221.