

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(78) 23 final

Brussels, 30 January 1978

NEED FOR COMMUNITY ACTION TO ENCOURAGE
EUROPEAN INVESTMENT IN DEVELOPING COUNTRIES AND
GUIDELINES FOR SUCH ACTION

(Commission communication to the Council)

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(78) 23 final/2

Brussels, 28 February 1978

ONLY CONCERNS THE ENGLISH VERSION

CORRIGENDUM

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CORRIGENDUM

page 6, last §

After the first sentence of this paragraph, please add the following:

These rules will apply only to new investments and existing investments conforming to the laws of the host country, being an independant and sovereign state; they will not be substitutes for bilateral agreements, but will complete them.

Introductory Note

This document represents an initial Community approach to encouraging European investments in the developing countries.

The use of the Community dimension for the encouragement of investments is proposed by the Commission for three purposes :

- to assist the economic development of the developing countries,
- to promote the interests of the Community and its economy,
- to contribute to the harmonious development of the world economy.

The proposed system is based on general agreements completing the network of national protection agreements to be concluded between developing countries and the Community as a whole, and on measures to promote selectively investments of particular interest to the Community and in the host countries on a project by project basis.

A. BACKGROUND

In the matter of European investment in the developing countries, there is as a rule a convergence of interests between :

- the developing countries, which, in order to supplement their own factors of production, are dependent on imported capital, technical knowhow and management capacity (these three items being combined in European investment operations) ;
- firms, which are seeking the best possible locations in terms of production costs, raw materials and energy supplies and market access ;
- the industrialised countries, which are keen to see intergovernmental cooperation and in particular official assistance backed up by the private sector, whose contribution can also act as a valuable stabilizing factor in economic relations with the developing countries.

We are, however, witnessing real blockages in this field. Developing countries sometimes resort to measures which are considered by investors as incompatible with the exercise of their business activities. On the other hand, investors do not always show sufficient understanding for the concerns of the host countries. At any rate, investors tend to consider as high the non-commercial risks that they run in directing their activities towards the developing countries.

When a considerable number of developing countries became independent approximately 25 years ago, the fears felt about investment conditions in those countries were essentially restricted to the direct risks of expropriation or serious public disorder. Since then, the problems have become more varied and more diffuse. Now they consist mainly of creeping expropriation measures such as the gradual erosion of exploitation

conditions, imposition of additional charges, obstacles to a freely-determined export policy and interference in management. In so far as investors are prepared to enter into precise obligations towards the host countries and in particular to integrate their activities in the development policies of those countries, they demand protection from such risks as a prior condition for any investment.

The problem of the investment climate in the developing countries and its repercussions on investors' decisions has certainly had an influence on private investment flows from the Community to the developing countries, which have been stagnating since 1972 and are even threatening to decline dramatically in certain sectors, as will be shown below. This trend is increasingly disturbing since it is likely in the long run to harm the economic and political interests of both the Community and the developing countries.

The Community has a vital interest in seeing its network of investments in the developing countries expand at the same rate as those of its competitors in trade, particularly the United States and Japan. It is therefore essential that a large number of major investments be made in the various sectors of the developing countries' economics in order to :

- maintain and strengthen the presence of European industry and trade on the markets of the developing countries in the face of international competition ;
- provide a durable and expanding base for trade between industrialized and developing countries ;
- provide the Community with more secure and diverse supplies of raw materials, etc.

It is also important during the present period of world economic crisis to sustain external demand by increasing financial flows for the most promising earmarked activities in the Third World - a subject that will be taken up again in Commission Communications. An increase in investment flows would have a direct and beneficial effect on external demand for the products of the Community's capital goods industries and for goods to service investment operations.

From the viewpoint of the developing countries, particularly those with close economic relations with the Community, the stagnation of Community investment threatens to have a serious effect on economic development and on industrialization in particular. In addition to the repercussions on their external earnings, which they need in order to be able to develop their economies, in the long run such a trend would seriously affect their technological and scientific development and their capacity for managing the modern sectors of their economies.

The Commission is particularly preoccupied by the situation in the mining sector. In recent years there has been a disturbing decline in European companies' mining and exploration activities in the Third World. In 1961 expenditure on exploration in these countries represented 57 % of European companies' expenditure on exploration in the world whereas in the period 1973-75 this proportion had fallen to 13,5 %.

This tendency clearly represents in the more or less long term, a serious danger to mineral supplies for the Community's manufacturing and transforming industries as well as for the world markets for many mineral products with all the negative economic results which would follow.

From the geological point of view however, the bulk of exploration should be taking place in the developing countries⁽¹⁾. Moreover in terms of necessity of supplies, it is obvious that the industrialized countries to which investment resources are currently flowing cannot constitute a solution in the medium term because they will consume a growing proportion of their own mineral production.

The main reason for the stagnation of investment in this field is the difficulty faced by the mining companies, but particularly by the banks which finance them, in taking on the considerable medium and long term financing commitments involved in starting up production as long as they feel that, in many Third World countries, they run non-commercial risks to which they feel they should not be exposed.

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(1) For five essential minerals (cobalt, tin, phosphates, tungsten and copper), it has been estimated that between half and almost all free world supplies will have to be provided by the developing countries in 1985.

This is the reason why precise requests for Community action to encourage investment in the developing countries have been addressed to the Commission by a European consortium of mining companies.

There is no doubt that all the parties concerned stand to benefit from the removal of these blockages and the establishment of an appropriate framework to encourage, facilitate and provide security for investment in the developing countries in both mining and other sectors and ensure the harmonious integration of that investment in the developing policy of the host country and in the policies of the Community.

B. NEED FOR A COMMUNITY APPROACH

In nearly all the Community countries, there are procedures and mechanisms designed to protect, guarantee, and sometimes even promote national investments abroad, including investments in developing countries. These national systems, whose scope varies widely⁽¹⁾, are not regarded as adequate by the firms concerned. In many cases, it is considered that the cover is too narrow. There is very little cover for multinational operations, and yet it is often highly desirable that investors of different nationalities should unite their efforts and share the risks.

Various attempts have been made to find solutions on a world scale to the problem of the security of investments, but they have not succeeded. There are many reasons for this, mostly arising from the variety of situations and doctrines - for example, the determination of the Latin American countries not to accept international arbitration.

The CIEC showed that the limits to a worldwide approach may be reached very quickly, even before a start can be made on the operational stage.

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(1) Only some ten developing countries have signed **protection agreements** with a number of Member States. The Federal Republic of **Germany is** the only member country with a satisfactory number of agreements. Guarantee mechanisms vary **in intensity from one Community member** country to another ; only one of the Member States uses **them to** any significant extent. Three Member States are still **without a** guarantee system.

However in the Paris Conference significant progress was made as regards recognition of the value of foreign investment for development and the desirability of a good secure investment climate in developing countries.

Since national measures are necessarily incomplete, and since there are no satisfactory facilities at world level, the Community seems to offer the right dimension for action to promote investment in the developing countries. Community measures would not replace action by the Member States but would be a useful supplement, especially for extending contractual links between member countries and developing countries where investment is concerned, and for limiting non-commercial risks for certain investments considered vital for the Community and its partners.

Community measures in this field would supplement the development co-operation measures taken by the Community (Lomé, Mediterranean agreements, trade cooperation agreements, etc.) and increase their impact.

In addition, the European Community, which is not pursuing any policy of domination, and which comprises nine countries with a wide range of sympathies, would be in a better position than any of its Member States to make itself heard whenever difficulties arose.

C. THE INSTRUMENTS OF COMMUNITY ACTION

The proposition the Commission envisages two categories of action :

- the first one involves the negotiation of agreements (or of clauses to be included in global agreements) between the Community and developing countries or groups of developing countries on basic rules relating to the treatment of foreign investment.
- The second involves specific projects - selected because of their particular interest - and envisages the conclusion of specific protection agreements on a project by project basis, the granting of guarantees and measures to promote investments.

1. Basic rules on investment protection

Bilateral agreements already exist between Community Member States and developing countries which give investment protection and lay down - more or less precisely - impartial and equitable means of settling disputes.

At the multilateral level several attempts to establish a code or convention on the protection of foreign property have failed : success has been achieved only as regards arbitration ; the International Centre for Settlement of Investment Disputes (ICSID) was set up in 1966 to provide machinery for settling disputes between governments and foreign investors. However, the fact that very few cases have been submitted to the Centre for a ruling shows its limitations although it may be that current initiatives to extend its scope of operation will improve the situation.

At the regional level of the Euro-Arab Dialogue on the other hand, the Arabs have put forward proposals which offer the possibility of a genuine solution to the problem of investment protection.

It is logical furthermore, that the European Community, which has co-operation agreements, many of them bold and original, with numerous developing countries, should wish to include clauses relating to investment protection which would improve the possibilities for investment cooperation in the interest of both the developing countries concerned and the Community.

The Commission therefore proposes that, in future, every favourable investment opportunity should be taken to conclude agreements on basic rules between the Community and one or more developing countries. These rules will fix the norms of good conduct of the parties concerned - host countries and investors - in the following areas : transparency and stability of investment conditions, non-discriminatory treatment of investment, possibility of transfer of income and capital, fair and equitable treatment of the investors property, behaviour of investors (e.g. compliance with the host country's laws, insertion in its development programme) and procedures for settlement of disputes. A clause would also be included providing for the possibility of specific protection agreements on a case-by-case basis which are discussed below.

Whenever the Community and a developing country (or group of developing countries) have a cooperation agreement comprising other provisions in favour of the contracting parties clauses relating to investment should be incorporated into the cooperation agreement itself. Accordingly, the Commission intends to propose to the Council that this should form part of the negotiating briefs for Lome II, any further financial protocols with southern Mediterranean countries, and other cooperation agreements.

Where there is no trade or cooperation agreement, the agreement on investment protection will be an independent instrument ; however, it may include clauses for cooperation between firms concerned and the developing country in question. It may also be appropriate to provide for a forum for discussion in such agreements, so that each of the contracting parties can air any problems it encounters.

2. Measures for specific projects

Although agreement on basic investment rules will help to improve the security of all investments, the Commission believes that in certain areas of particular interest, such as, initially, the mining sector (see pages 3 and 4 above) further measures are necessary in order to stimulate investment and guarantee more effectively the interests of the Community and the host country.

For this purpose three instruments should be used to stimulate new ventures on a project by project basis :

- specific project agreements : agreements between the developing host country, investing firm and Community authorities on the precise terms and conditions governing a given project,
- guarantee : insurance offered by the Community to cover investments in developing countries against non-commercial risks ; this guarantee would be linked to the conclusion of specific project agreements;
- promotion : financial contributions from the Community and other international organisations to selected investment projects.

a. Specific project agreements

The second instrument of Community-inspired investment protection is something of an innovation - specific agreements to be negotiated with the host country concerned by the selected project.

The Community would be a party to these agreements together with the host country and the investor. The agreements would relate to the precise terms and conditions applying to the individual projects and stipulate the rights and obligations of the investor and host country in the same way as conventions of establishment between these two parties.

Since the Community would be a party to the specific agreement the investor would be assured of the involvement of the Community authorities in the case of a dispute resulting from a unilateral modification of these terms and conditions.

Where basic investment rules are operative the specific agreement would refer to them. In other cases the specific agreements would include clauses relating to these basic rules.(1)

The specific agreements would cover the obligations and modalities of consultation between the three signatory parties on the conditions of distribution of the product of the investment.

Specific agreements would also include precise modalities to be followed in cases of renegotiation, disputes and expropriation, and rules on arbitration procedures.

In principle projects eligible for the conclusion of a specific protection agreement should:

- conform to the criteria of priority fixed by the Community (e.g. mining sector)
- be undertaken by firms from at least two member states,
- involve a large capital (say investments of \$50 m or more).

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(1) In this respect the specific project approach would lend itself inter alia to Latin American countries which, so far, have always refused to conclude general investment protection agreements.

b. Community guarantee

The protective effect of specific agreements would be reinforced if the Community could offer the investor a guarantee against non-commercial risks. Such a guarantee would provide for compensation of the investor for losses which he could incur in spite of the political and legal security which preventive agreements would give.

The existing guarantee mechanisms in most of the Member States help to encourage investment abroad by European companies and there is no question of reducing their importance or affecting their operation.

These national mechanisms however appear to be inadequate notably where very large investments involving substantial risks need to be covered and particularly in the case of projects undertaken jointly by investors from several Member States.

In this latter case an investment project can be dropped because of the absence of a national insurance system, the exclusion certain sectors, the inadequacy of insurance ceilings, the rigidity of conditions, a diverging appreciation of the risk or the interest which a venture represents for the national economy.

At the international level, the impossibility of reaching agreement on a guarantee for foreign investment is as clear as in the case of protection agreements, as the failure of the IBRD's 1972 proposition to create an "International Investment Insurance Agency" (IIIA) has shown.

For all these reasons, it is important to find a Community solution for investments which cannot be covered satisfactorily through national guarantee agencies.

The approach involving a direct, structured cooperation between national investment guarantee agencies, in other words joint insurance together with a mechanism for concertation and decision, would have little chance of success given the divergent practices in the different Member States.

The Commission therefore proposes that a guarantee should be instituted at Community level.

The operation of the guarantee would be linked to the existence of a specific agreement of the kind described in the preceding chapter. The guarantee would result from a bilateral contract between the Community and investor, concluded at the request of the latter. It would cover war risks, restrictions on free transfer, expropriation and any other unilateral modification of the dispositions defined in the specific agreement, which affect the viability of the investment.

As at the national level firms wishing to have recourse to the guarantee will be asked to pay a premium. The rates of the premium could either be adjusted to take account of the risk represented by the individual project or be based on the average of all the risks to be carried by the system in general or for a particular sector. This question as well as those relating to other technical modalities of the system (extent of cover of the capital and profits, cover in case of loss etc.) should be agreed, as should any cooperation arrangements to be worked out with the private insurance sector.

The receipts from the premiums paid by the assured should normally ensure the financial autonomy of the guarantee mechanism, given that the obligatory existence of the preventive instruments mentioned above will limit the risks considerably. In the case of receipts being insufficient to cover expenditure resulting from payment of compensation for losses, it would be necessary to have recourse to the Community budget, in line with modalities to be fixed and proportions to be defined. In the case of payment of compensation to the investor the Community would be subrogated into all its rights with respect to the host government.

The Community guarantee will necessitate the establishment of a management committee or guarantee commission made ^{up} of representatives of the Commission and Member States to examine requests for cover.

The Commission looked at this problem five years ago (1) and its position has changed in the interim. Now its approach only covers the developing countries where the need for measures to encourage investment is most felt. Also the Commission now sees the question of investment guarantees in a wider context bringing in the protection and promotion aspects.

Lastly it had proposed the creation of a Community guarantee agency. It now feels that a much lighter framework would be suitable and that Community guarantees should be administered by existing national agencies in the Community, within the context of the regulations and safeguards adopted at Community level. These national agencies would be paid for their services, their remuneration being included in the costs of the system.

c. Promotion

Financial contributions from official sources would act as an element of investment promotion additional to the effect of the agreements and the guarantee mechanism.

Talks with investors show that in the eyes of company managers, this aspect of support for European investments in developing countries is significant in that it improves protection, and makes guarantees less necessary: direct intervention in the form of international financing implicates the organization concerned should the investment be threatened.

In this way even a small contribution can be helpful in reducing non-commercial risks.

(1) Proposal for a Council regulation establishing a system of Community guarantees for private investments in non-member countries COM(72) 1461 of 20 December 1972.

From the financing angle, it is desirable to contemplate large scale measures at world level. The IBRD has already taken action in this respect. The increased opportunities which the planned increase in capital will give the Bank and the International Finance Corporation should in part be used for more frequent and rational operations in the form of direct participation or preferential financing for investment, particularly in the mining sector (1).

As regards a more direct contribution from the Community, this course has already been adopted, namely when the ECSC granted loans on preferential terms for iron mining projects. The European Investment Bank can also take action of this kind in accordance with its Statute (2). It may be appropriate for it to participate in some of the selected projects by means of financial contribution to the risk capital, loans or technical assistance.

Once the principle is settled, more detailed proposals will need to be framed following discussion with the Member States and the financial institutions concerned.

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(1) In a recent IBRD report (concerned with the setting-up of an International Resources Bank) it is recommended that by 1980 the IBRD and the IDA double the number of mining and energy projects financed by them to arrive at a loan programme totalling US \$ 750-850 million. The regional banks and the IFC should also play a greater role in the financing of mining projects.

(2) Article 18(1) of the EIB's Statute enables it to grant loans outside the territory of the Community upon an unanimous decision of its Board of Governors.

This Commission communication is designed to enable the appropriate Community authorities to debate the principle of the matter. In the light of the conclusions reached, the Commission will make its proposals more explicit, on the basis of the guidelines that emerge from the debate.

In giving further thought to this matter, as it will have to before any final specific proposal can be made, the Commission will consult business organizations and national agencies with experience in the matter, whose assistance will be essential for the preparation and implementation of a policy of this kind. In this connection, the Member States should ask their authorities and agencies to help the Commission in any way they can to finalize the proposed system.

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D. CONCLUSION

The uncertainty and insecurity currently hanging over European investments in many developing countries impedes their efforts to develop their economies and improve their purchasing power. As a result, opportunities to export capital goods from the Community are cut down. This trend is damaging to the economies of both the developing countries and the industrialized countries. In addition, in the mining sector, the drop in European mining investments in developing countries ultimately poses a threat to the Community's supplies of raw materials.

Attempts to settle this problem at world level have so far been disappointing, and there is no sign that this state of affairs can be improved in the near future.

Whereas purely national approaches seem in most cases to be too fragmentary, a Community approach would enable the Community's economic weight and special relations with many developing countries to be used to reach realistic and balanced solutions.

The Commission accordingly requests the Council to approve the guidelines set out above.