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INVESTMENT PROMOTION AND PROTECTION CLAUSES IN  
AGREEMENTS BETWEEN THE COMMUNITY AND VARIOUS  
CATEGORIES OF DEVELOPING COUNTRY : ACHIEVEMENTS  
TO DATE AND GUIDELINES FOR JOINT ACTION .

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(Report from the Commission to the Council)

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Subject : Investment promotion and protection clauses in agreements between the Community and various categories of developing country : achievements to date and guidelines for joint action

Introduction

In January 1978 the Commission presented a communication to the Council setting out the guidelines for Community action to encourage European investment in the developing countries.

Since then the Community has had to take decisions on the inclusion of investment clauses in cooperation agreements to be concluded with various developing countries or groups of developing countries. Negotiations on this matter have been successfully completed with the ACP States, ASEAN Member countries, Yugoslavia and Brazil, and taken to the stage of a draft convention in the framework of the Euro-Arab dialogue ; further negotiations, notably with India and the Andean Pact countries, are due to begin shortly.

This would therefore seem to be a suitable moment to review progress to date in this field and set out guidelines for joint action to be undertaken as regards both the implementation of the provisions negotiated so far and the developing countries with which negotiations are being or are shortly to be held.

Such is the aim of this report.

It is not, therefore, concerned with the Community position to be adopted in international discussions on the subject of foreign investment. That matter has been dealt with inter alia in a Commission working paper in connection with the preparations for UNIDO III.

## I. Achievements to date

The 1978 Commission proposals covered two types of arrangement :

- the negotiation of agreements (or clauses to be incorporated in cooperation agreements) with developing countries or groups of developing countries, regarding the basic rules for the treatment of foreign investments
- measures to be applied on a case-by-case basis (in particular the conclusion of specific agreements backed up where appropriate by Community financial guarantees) for the selective promotion of investment projects of special interest both to the Community and the host country.

In the negotiations which have taken place so far with various developing countries, progress has been made on various ideas put forward by the Commission in the field of legal protection for investments, but the examination of a financial guarantee (or backup for action by the Member States), which constitutes an internal Community instrument, has still produced no positive results.

1. The Euro-Arab dialogue : efforts have so far focused on the more general theme, namely basic rules for investment. Following an agreement between the two sides on the principles which should govern a convention in this field, the European members of the working committee concerned have drawn up a draft Euro-Arab Convention on mutual promotion and protection of investments. This document is a fully worked-up and detailed legal text, which stands a good chance of being approved without substantial amendments when the suspended dialogue is resumed.

The work done in this context clearly revealed a consensus within the Community on the detailed contents of an investment protection accord to be submitted to a specific group of developing countries. Admittedly in the case in point such a consensus was made easier by the fact that several of the Arab countries likewise had an obvious interest in reaching an agreement which would protect their own investments in Europe. But the

specific nature of these Arab investments (mainly financial assets) posed particular problems for the European side which is more used to discussing the treatment of direct investments ; this was the case notably with regard to the non-discriminatory treatment of portfolio investments and the transfer of investments and income. Moreover it was necessary at the outset to convince our Arab partners not to insist on the coverage of monetary risk (against inflation and exchange rate fluctuations) and to find a response to the Arab claim to be allowed to derogate from applying national treatment on the grounds of development policy.

2. Negotiations for the renewal of the Lomé Convention : The Community proposed to the ACP States that the new agreement should contain certain clauses aimed at the promotion and protection of investments in general, plus more specific provisions covering specific investments in the mining and energy sectors of particular interest to both parties.

a) On the treatment of investments in general, the Community, because of the difficulties presented by agreements on basic investment rules and a time schedule ruling out lengthy negotiations on such rules, had simply put forward a formula inter alia affirming the importance in the mutual interest of concluding reciprocal investment promotion and protection agreements. This proposal had to be dropped in the final stages of the negotiations owing to rigid opposition from a handful of ACP States fearing that in the circumstances accession to the new Convention would morally oblige them to sign such agreements. The proposed formula was replaced by a much more general declaration of intent "to take such steps as would promote investment" in fields of mutual interest.

The Community proposal for non-discrimination between investments from the various Member States, on the other hand, was adopted and spelled out in a joint declaration annexed to the final act of the Lomé Convention. The application of this right is based on bilateral inter-governmental agreements relating to the treatment of investments which shall serve as reference agreements.

For the purpose of applying non-discriminatory treatment, the contracting states concerned are to conclude agreements in the form of exchanges of letters or some other appropriate form.

The declaration specifies that such agreements will cover disputes relating to investment only where they arise after the entry into force of the new Convention ; but investments made before that date which have not given rise to any dispute may also qualify for non-discriminatory treatment, since it is stated that their treatment shall be examined by the parties concerned, case by case, in the light of the provisions of the agreement of reference.

The non-discrimination clause is without precedent in the field of the legal protection of investments, and in principle it should be equivalent in effect to the Community agreements on basic rules proposed by the Commission i.e. put firms from all Member States on an equal footing as regards treatment of their assets in the developing countries concerned. It remains to be seen to what extent this objective can be attained in relations with the ACP States by means of the bilateral agreements provided for in the declaration.

In any event, the declaration has not settled the problem of treatment of investments in ACP States which have not concluded investment agreements and do not intend to do so.

b) Regarding the promotion of mining and energy investments in ACP countries, both sides recognized the importance of specific protective measures as a means of encouraging European firms to engage in this sector and thus bring into play the increased opportunities opened up by the new Convention for EDP and EIB participation, which should essentially play the role of catalysts for investment.

That is the purpose of the joint ACP-EEC declaration annexed to the new Convention at the request of the ACP States which provides for the possibility of concluding agreements between the ACP States on the one hand and the Community and its Member States on the other, relating to specific mining and energy sector projects promoted by the concerned ACP State, where the Community recognizes that such projects are of interest to it and European capital is involved in the financing.

Thus the negotiations with the ACP States showed those countries to be unwilling to bind themselves in any way they feel is incompatible with national sovereignty, for example by conceding any automatic or retroactive force to the extension of rights granted to a third party, but not opposed in principle to discussing matters of investment. The reference to specific agreements in the mining and energy sector was never called into question in the negotiations. Similarly, a number of ACP States were notably open-minded regarding the conclusion of agreements in the investment field - as indicated for instance in the speech by the President of the Council of ACP Ministers at the signing of Lomé II - provided their sovereignty is safeguarded.

The negotiations on the investment clause included in the Cooperation Agreement recently signed with the five member countries of ASEAN (Indonesia, Malaysia, Philippines, Singapore, Thailand) were helped by the open attitude of these countries towards foreign investment which they consider necessary to develop and diversify their industrial capacity and build up their technological potential.

Evidence of this can be seen in the promotion measures taken by these countries themselves and the relatively high number of promotion and protection agreements concluded with Member States of the Community. In the investment clause of the Agreement, which is based on the text adopted on this matter at the 1978 Community-ASEAN ministerial meeting, it is laid down that, in order to improve the already favourable investment climate, the parties should encourage efforts to extend the agreements on investment promotion and protection, while ensuring that these agreements endeavour to apply the principle

of non-discrimination, aim at providing fair and equitable treatment and reflect the principle of reciprocity. The Council stated that the agreements provided for in the clause are to be concluded by the Member States of the Community and the member countries of ASEAN.

What is involved, therefore, is a declaration of intent by the member countries of both groupings to add to the network of bilateral agreements this being aimed more especially at those Member States which have concluded very few, if any, agreements of this kind so far. Among the three principles to be followed in concluding new agreements, the reciprocity and fair and equitable treatment criteria are standard for such agreements.

The non-discrimination principle, on the other hand, is based on the Lomé II formula and means that any new agreements concluded in the EEC-ASEAN context should not deviate too far from existing agreements, so as to avoid discrimination between investors from different countries.

However, unlike the joint declaration in the Lomé Convention) the formula adopted in the cooperation agreement with the ASEAN countries does not establish a right to non-discriminatory treatment.

In any event, the existence in the EEC-ASEAN context of a considerable number of agreements of differing scope concluded by certain Member States would have made strict application of the principle of non-discrimination extremely complex and haphazard.

4. The investment clause in the recently concluded agreement between Yugoslavia and the Community lays down that the Contracting Parties should take steps to promote and protect each other's investments and in this regard endeavour to conclude reciprocal investment promotion and protection agreements to their mutual advantage.

This formula represents something of a commitment by the parties to establish contractual links in the sphere of investment incentives, without actually specifying the nature or content of the agreements to be concluded in this area.

Community contains an investment clause of general character, according to which the Contracting parties intend to facilitate and promote, by appropriate measures, favourable conditions for the expansion of investments, on advantageous bases for each of the interested parties.

This opening clause, although not involving any precise undertaking, will make it possible for the parties, to consider concrete measures in order to attain the aim laid down in the clause.

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The results obtained hitherto with incentives for European investment in the developing countries reflect the diversity of the positions of the various negotiating partners, the variety of prior arrangements for foreign investment and the Community's own different interests.

They represent the acquis communautaire in this sphere and may consequently have some value as a precedent for current or future negotiations with other developing countries.

The precedent lies first and foremost in the very fact of having included in a cooperation agreement between the Community and non-member countries clauses aimed at protecting, and thereby promoting, foreign investment of mutual benefit to the host country and the Community. Such arrangements are also an integral part of industrial cooperation between the Community and the developing countries concerned because they do not stem from a concession requested by the Community in return for various benefits but from a clear grasp of where mutual interests lie.

This is obviously particularly applicable to developing countries which can hope to benefit from the reciprocity built into these clauses or wish to keep the option to use it open.

With regard to the content of investment clauses, the formulas adopted up to now, i.e. a formal agreement on the basic rules, the clause on non-discriminatory treatment between Member States, specific agreements for individual projects and the clause opening the way for subsequent measures will provide a very useful basis for future negotiations.



II. Guidelines for future Community action to encourage investment in the developing countries

Guidelines for the application of the investment clauses in agreements concluded by the Community

Unlike the Euro-Arab convention on the promotion and protection of investment, which, when signed and in force, will in itself constitute an immediately applicable commitment under international law, the investment clauses in the other agreements concluded by the Community set out principles and intentions which the Contracting Parties will have to give concrete shape later.

The Community's action here could be based on the following guidelines :

1. In the context of the new Lomé Convention

- With regard to the non-discriminatory treatment provided for in the joint declaration relating to Article 64 of the Convention, it is up to the Contracting States - and in particular the Community Member States concerned - to make such treatment applicable by requesting the host ACP country the conclusion of an agreement relating to the treatment of investments which would be based on bilateral investment treaties, known as "reference agreements" (1).

As regards such reference agreements concluded before the entry into force of the Convention, the application of non-discriminatory treatment shall take into account any provisions in the reference agreement ; the concerned ACP State has however the right to modify or adapt this treatment when international obligations and/or changed de facto circumstances so necessitate.

The parties concerned then agree on the form of their agreement.

It would be advisable for the Member States to discuss within the Council how they intend to use the right to the non-discriminatory treatment of investment. At a later stage it might prove useful to have a notification procedure which would enable the Member States to be informed as a matter of course of any new bilateral agreements and "extension agreements" concluded".

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(1) In this respect, the list of reference agreements inofficially submitted during the Lomé negotiations should serve as a basis and brought up to date periodically. In the case an ACP State has concluded several bilateral agreements, the parties concerned shall choose the one that will serve as "reference agreement".

- In accordance with Article 63 of the Convention, which points out the need to take such steps as would promote investment, and in order to solve the problem of the treatment of investment operations in ACP States which have not concluded bilateral investment agreements and which are therefore not bound by the declaration on non-discrimination, the Community and its Member States should explore the possibility of concluding with one or more of those ACP States which wish so investment agreements which would help to encourage the inflow of European capital while fully safeguarding the sovereignty of the host country.
  
- Lastly, the Community and its Member States should endeavour, in conjunction with the host countries concerned and on their initiative, to promote European investment in mining and energy development projects in the ACP States to which both sides attach particular importance. In order to do this, they should make use of the increased opportunities for action by the EDF and the EIB in this sector opened up by the Convention, and also conclude with the ACP States concerned agreements on specific projects part-financed by European capital.

European undertakings would have a greater incentive to invest if the Community and the Member States could offer them, in addition to the preventive protection constituted by the specific agreement signed by the public authorities, a financial guarantee against non-commercial risks, in cases where such guarantees could not be provided by national guarantee bodies (1).

The Commission proposes that this question be dealt with during the actual examination of a specific agreement, on the basis of the proposals it has already made in this respect (2).

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(1) The importance of having a multilateral guarantee system for covering the particularly high risks in this sector is brought out by such moves as the Inter-American Development Bank's recent proposal to create a facility of its own along these lines in order to encourage mining and energy investment operations in Latin America. In this respect, it is striking that most of the Member States of the Community have had a favourable or at least interested first reaction, when the proposal was tabled.

(2) see COM(78) 23 final of 30 January 1978 - pp. 9-11  
and COM(79) 130 final of 14 March 1979 - pp. 11-13

2. In the context of the Agreement with the member countries of ASEAN

Relatively speaking, the largest number of investment promotion and protection agreements have been concluded by the Member States with the member countries of ASEAN. Among other things, this explains the solution specifically adopted in the Cooperation Agreement, namely bilateral extension of the network.

The Member States will therefore have to address themselves to this task ; they will, of course, start from very different points, concerning the number of bilateral agreements concluded.

It has already been mentioned in connection with the principles to be followed in negotiating new agreements that reciprocity and fair and equitable treatment should not cause any problem, while the principle of non-discrimination should be conceived sufficiently flexibly, thus generally making for a degree of protection which is no less than that already afforded by existing agreements.

Moreover, it would seem to be in the contracting parties' interest not to restrict their activities in the investment field to expanding the network of bilateral agreements.

- Industrial and technical cooperation, with particular emphasis on mining operations - which the Agreement recommends should be encouraged - could be facilitated, as in the case of the ACP States, by the conclusion of agreements on specific projects between the Community and the Member States, on the one hand, and the member countries of ASEAN, on the other.
- In addition, the Community should join with its ASEAN partners in seeking to develop contacts and promotional activities between the two regions' firms and organizations, particularly to pave the way for new European investment or the acquisition of holdings in South East Asia. Such activities, which got off to a promising start with the two conferences on industrial cooperation, might be given a more institutional form, still to be determined.

### 3. In the context of the Agreement with Yugoslavia

The fact that Yugoslavia has agreed to include a clause on promotion and protection of foreign investment in its Agreement with the Community might be understood to mean that it is open to this type of inflow, provided that certain conditions are satisfied and account is taken of the specific features of its economic system under which, for instance, no foreign firm may have a majority shareholding.

In addition, Yugoslavia has concluded investment promotion and protection agreements with two Member States.

As soon as the agreement enters into force, the Community should therefore propose implementing the investment clause and exploring with the other Contracting Party what content and form the reciprocal investment agreements provided for in this clause might be given.

As regards the basic rules for the treatment of investment, the most effective solution - since it avoids the necessity of negotiating a set of agreements presupposed by such solutions as the extension of bilateral agreements or non-discriminatory treatment - would be an agreement between the Member States as a whole and Yugoslavia.

The relationship between a multilateral agreement of this kind and bilateral agreements might be dealt with, as in the draft Euro-Arab convention, by appropriate clauses safeguarding the interests of the Member States while offering undertakings maximum protection.

The parties could also explore the possibility of concluding agreements on the encouragement of investment in a number of sectors pursuant to the Agreement, which makes particular provision for the participation of Community undertakings in research, production and processing programmes in connection with Yugoslavia's energy resources.

4. In the context of the Agreement with Brazil

Brazil continues to be one of the main focuses of European investment flows to the developing countries in general and South America in particular.

The investment conditions and climate in Brazil are generally regarded as stable and satisfactory both by undertakings and by the Governments of the Member States, which regularly agree to provide cover for investment projects against non-commercial risks, despite the fact that the country has never signed any international investment protection agreement.

This satisfactory state of affairs could be further improved if Brazil decided to abandon granting favourable investment conditions on a unilateral basis in favour of international cooperation in this field.

In order to implement the future developments clause in the agreement with Brazil, specific agreements for individual projects might prove a particularly appropriate instrument as it might logically be perceived by Brazil as a means of safeguarding its sovereignty more effectively. Such agreements might turn out to be a more pragmatic solution than agreements on the basic rules.

In view of the type and scale of the investment projects to be undertaken in Brazil, especially for developing its mineral resources and energy potential, specific agreements might help to step up the involvement of Community undertakings in the country, thus serving the interests of both parties.

## B. Guidelines for future negotiations

Those developing countries with which the Community is preparing to negotiate cooperation agreements, namely the Andean Pact countries and India, display the same reluctance to incur intergovernmental legal commitments to promote and protect foreign investment, yet at the same time they are interested in the idea of such inflows.

The establishment of closer relations between these countries and the Community might therefore be conducive to exploring new forms of cooperation in this field, taking account of the different ways in which the host countries view the role of foreign investment in their development processes.

In this connection, the various cooperation agreements should comprise general opening clauses specifying the aims of investment cooperation - as envisaged in the agreement with Brazil - so that the parties can consider at a later stage what practical steps should be taken to attain these aims.

With this in mind, the Community might base its attitude towards the different developing countries on the considerations set forth below.

### The Andean Group

The encouragement of investment should be one major aim of the cooperation agreement which the Community is about to conclude with the five member countries of the Andean Group, set up in 1969 by the Cartagena Agreement.(1).

Despite the relative importance of the Andean Group among the developing countries - it is the fourth largest exporter and importer, the seventh largest producer and one of the main suppliers of raw materials - European investment in these countries is low : in 1977 net direct private investment by the Member States was only \$ 36 million (compared with \$ 354 million by the United States) and has never exceeded 8 % of total investment in Latin America.

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(1) Initially this agreement was signed by Bolivia, Chile, Colombia, Ecuador and Peru ; Venezuela acceded to it in 1973 and Chile ceased to be a member in 1976

The European undertakings have not been reassured by the Andean countries' stated position on foreign investment, causing them to share the opposition of the other Latin American countries to international commitments on this point (1) and, in particular, to establish in 1971, under their Decision n° 24, subsequently amended by other decisions, a common set of rules for the treatment of foreign capital requiring all members of the Group to incorporate a number of substantive and procedural provisions into their national legislation, though leaving them some latitude in determining their national policies in this connection.

The most important of these provisions concern the gradual conversion of the foreign firm into a "joint" undertaking (with national investors exercising effective control and holding at least 51 % of the shares), restrictions on the transfer of capital and earnings, less favourable treatment than that accorded to national firms (especially in respect of credit facilities and trade within the Andean Group) and detailed rules on the transfer of technology.

The existence of this legislation should not, however, prevent the Community from exploring possible forms of investment cooperation with the Andean Group. The Group would seem to be taking a rather more open attitude to foreign investment, as is borne out, for instance, by its positive response to the Inter-American Development Bank's proposal to set up a multilateral guarantee fund to encourage investment in the mining and energy sectors in Latin America, despite the fact that this would mean relinquishing some degree of sovereignty.

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(1) The only exception has been the "conventional" investment protection and promotion agreement concluded in 1965 between Ecuador and Germany ; though this agreement is still formally in force, it obviously no longer reflects Ecuador's position and thus would not be a suitable "reference agreement" for other Member States.

Moreover, the Community, which has an interest in encouraging the process of integration begun within the Andean Group would appear to be better placed than others to discuss ways of increasing the flow of investment under conditions satisfactory for both parties. Faced with the common attitude of the Andean countries on this question, the Community for its part must establish a joint position.

The Community could accordingly put forward the idea of an agreement to cover investments, which would embrace all the member countries of the two regions and would take due account, inter alia, of the intrinsic features of the Andean common system.

Since the Andean countries are anxious to develop their large mineral and energy resources, they might also be interested in the idea of specific agreements for individual projects.

#### India

India considers that the Indian Constitution together with the country's rules and regulations give all security to foreign firms engaged in business activity open to foreign investment.

In 1964 India concluded an investment protection agreement with the Federal Republic of Germany incorporating the essential basic rules applicable in this field.

However, this is a provisional agreement between governments which was not ratified by the parliaments concerned (contrary to practice in the case of all other German agreements), and its value as a precedent is therefore limited. India, moreover, appears to be opposed to the terms of this agreement being applied to all the Member States and unwilling to agree to even a mention of the subject of investment treatment in the cooperation agreement.

The Community, however, should propose that this important aspect of economic cooperation between the two parties be included in the agreement, at least in the form of a clause on improving the climate of investment, which would open the way for subsequent consideration of appropriate concrete measures.



## C. Possible negotiations with other developing countries

### Southern Mediterranean countries

All the Arab countries with which the Community has concluded overall cooperation agreements within the context of its "Mediterranean approach" would be covered by the Euro-Arab Convention on Investment Promotion and Protection. Approval of the Convention will be one of the priority items for discussion when the Euro-Arab Dialogue is resumed.

Hence, only if the Convention were not approved or the Euro-Arab agreement assumed a much more general character than planned at present, would the Community have to take the initiative of presenting its investment proposals through the Cooperation Councils, whose job it is to monitor the working of the Mediterranean agreements and propose further cooperation measures.

A similar proposal on investment cooperation should in any case be submitted to Israel.

### The Gulf States

The Gulf States would also be covered by the Euro-Arab Convention. Should the Community engage in negotiations with them with a view to concluding bilateral agreements, those agreements should either include a reference to the Convention or, in default of the Convention, provide clauses based on the result actually achieved in the Euro-Arab Dialogue.

### Other countries

Among the other non-member countries with which the Community could discuss the question of investment, particular attention should be given to China.

China has recently altered its position regarding the role which foreign investment can play in the country's development. It is important therefore to ensure that Community firms are able to participate in China's development efforts under the best possible conditions.

## Conclusion

Consideration of the Community's achievements in promoting European investment in the developing countries and of possible future action in this sphere, reveals the diversity of the situations in question and of the positions of the parties involved and, consequently, the difficulty of producing formulas which would be universally applicable. For this reason it has proved necessary - and will doubtless be necessary in the future - to have recourse to different variants of the two basic instruments proposed by the Commission, namely agreements on the basic rules for investment and specific agreements for individual projects.

Furthermore, certain guidelines emerge from the Community's action in this sphere, notably :

- the utility of raising the subject of investment with all partner developing countries, including those reluctant to agree to cooperation in this field ;
- the desirability of incorporating the basic rules on investment or other measures in an agreement distinct from the overall cooperation agreement, provided the cooperation agreement contains a clause opening the way for such measures ;
- the potential importance of the instrument comprising specific agreements for individual projects, preferably supplemented by financial guarantees, notably in the case of developing countries opposed to the conclusion of general agreements ;
- the Community's specific interest in negotiating investment clauses with groups of developing countries. A regional approach of this kind would permit a better balance of cooperation and would help to harmonize investment conditions by establishing at one and the same time a large number of contractual relations between the Community and the developing countries in question.