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INSURING PRIVATE INVESTMENT

Coming as I do from an insurance background where precision is paramount, I must admit that I found it somewhat disconcerting to be invited to talk about the insurance of private investments against a general background of European Community Investment in the Third World. My uneasiness stemmed from the realisation that it was not possible to determine the quantitative impact the existence of an insurance scheme has on the volume of national private investment. And yet, judging from statements made over the past 25 years by politicians, industrialists, bankers, and international organisations the availability of an insurance scheme has been deemed to be an important element in stimulating private investments in third countries. But I do notice that to the year end 1971 total guarantees outstanding by EEC investment guarantee underwriters were around the $ 373 million mark which in anybody's language is not a very significant figure.

To be sure I am not talking about the massive investments which have taken place in the last few years in the U.S.A. encouraged by inflation

which has eroded the power of the dollar and made American assets cheaper and easier for foreigners to buy. Indeed, I am advised that industry did not knock on the doors of their investment guarantee underwriters to insure their direct investments in the U.S.A. In total EEC Member States invested by the end of 1971 the massive figure of $ 7,763 million.

So, clearly, when the phrase "third countries" is used it must refer primarily but not exclusively, to developing countries.

There are, of course, several factors which motivate businessmen to invest in developing countries, but at all times there are three prime considerations which will determine whether or not an investment actually takes place.

Is the proposed venture profitable?

Is it safe?

Has the company funds available from its own resources, or can money be obtained from one of the many world wide or regional finance institutions?

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If a company believes the proposed venture is profitable, then it has to ask itself the question: is it safe?

Let us first consider what is meant by safe. Safety is normally a question of nationalisation and whether profits can be repatriated.

Therefore, one can start from the assumption that an investment guarantee scheme must give an investor protection at least against these risks.

What investment guarantee schemes exist at this moment in the Member States of the European Economic Community and what can be said about them? I think, as a general comment, it is only fair to say that this is a relatively new field of endeavour and of insurance. The first to be established was the German in 1960, followed by Denmark in 1966, the Netherlands in 1969, France in January 1971, Belgium in February 1971 and the U.K. in 1972. This leaves us with Italy and Ireland who have no investment guarantee scheme at all, and Luxembourg which comes under the

Belgian scheme. Because all these are relatively new their experience is insufficient to establish any definite indication of investors' reactions although the figure of $ 373 million mentioned earlier suggests either that an investment guarantee scheme is of marginal use or that there is something wrong with the schemes.

However, let us make a quick comparison between the existing schemes in the EEC.

These show, first of all, that they only cover what are called new investments.

While the object of all these guarantee schemes is to cover what is politely called non-commercial risks, there are differences in the way the specified perils are expressed. Having said that, however, all the schemes group the political risks into three categories.

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The first are Expropriation Risks. An expropriation risk arises when nationalisation, expropriation and confiscation occurs without compensation.

The U.K. alone covers creeping expropriation where the local business is not taken over but where government action deliberately impedes the operation of the business to such a degree that it cannot operate effectively.

The second category of risks are war risks including revolution, rebellion, civil war.

The third category are transfer risks which means the imposition of exchange control preventing or delaying the repatriation of profits and capital. Devaluation risks however are excluded.

All schemes provide coverage for equity investments although of course there are variations on a theme between all the schemes. For

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instance, France has a variety of schemes. There is, for example, a French decree of 1967 which limits the actions of the French investor. To qualify for insurance the French investor must invest in no more than 51% of the equity, and at the same time he must sell capital goods for the project in substantial sums. Under this decree the French only cover 15% of the value of the export contract, although the investor will receive 90% cover of his equity investment. The decree of 1967 was amended to cover certain other investments which are not linked to specific export contracts, but in this case the French must show that they will generate French exports in the future, and it is expected that these exports should represent three to four times the value of the total amount of the investment.

In March 1971 France introduced another scheme with a more comprehensive application in the sense that it provides for guarantees for investments in thirteen African Francophone countries plus the Malagasy Republic. The risks covered here are not merely limited to the traditional specified perils such as nationalisation, civil war and

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revolution as well as transfer risks, but also include "violation by the foreign authorities of specific undertakings related to the investment". These"specific undertakings" mean that an investment may receive protection, for example, against competitive imports of similar products and the investor may proceed with his investment relying on pledges by the host country to grant him such protection. If, therefore, the host country government grants import licences for similar products in spite of earlier assurances, the investor might be in serious difficulties. Therefore, under the 1971 decree this particular peril is specifically covered.

Now what about eligibility in qualitative terms? Most insurance schemes start from the premise that investment projects should be important for the development of the host country and that the project be approved by it. The Danes say that such conditions may be satisfied if the project to be considered forms part of the development programme of the host country or is specifically approved by the host country. The Germans say that a project must be of benefit to the host country as well

as to Germany. Furthermore, a German investor may only use the German scheme for countries with which Germany has concluded investment protection agreements - I believe that there are some 38 of these. Other countries in the EEC also require that there should either be some economic advantage to the capital exporting country or that it should promote exports.

As far as premiums are concerned there are minor variations, while the U.K., the Netherlands, Germany, Denmark and Belgium cover the three main risks enumerated earlier as one. In other words, as far as investors are concerned, it's all or nothing - no risk picking is allowed.

The duration of cover is normally for a maximum of fifteen years, except that the Germans provide exceptionally up to twenty years.

The percentages of losses payable varies between 75% and 95% with Germany being the most generous.

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So much for a rather quick comparison of the different existing schemes within the EEC.

What emerges is that while each Member State wants his national investment guarantee scheme to encourage investments in third countries by their nationals they do tend to go about it in different ways. And it is possible to discern without too much difficulty two distinct philosophies - the aid philosophy and the insurance philosophy. The first is distinguished by low premiums and a consideration of the developmental value of the investment to be insured. The second follows more closely the disciplines developed by export credit insurance where a higher premium is charged and where above all attention is paid to underwriting risks.

Some purists I know argue that it is difficult, if not impossible, to reconcile the two mainstream philosophies, and point to the oldest scheme of all, the American investment guarantee scheme which is at present the responsibility of the Overseas Private Investment Corporation.

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Although this Conference is devoted to Europe and the Third World, I think it would be helpful to comment briefly on OPIC, partly because it is the oldest scheme, partly because it is big and partly because it recently began to run into trouble. The Charter setting up OPIC tried to gloss over fundamental philosophical differences by instructing the Corporation to be all things to all men in the sense that OPIC was expected to run in a self-sufficient business-like way, at the same time as it was supposed to improve the United States balance of payments, as well as helping friendly poor countries to develop and at the same time giving a priority to American small businesses investing overseas. For about twenty years the American investment guarantee programme was deemed to be highly successful since premiums outpaced claims by a margin of 20:1. In 1970 problems arose in Chile so that OPIC was faced with claims for expropriated properties to the value of $ 440 million at a time when OPIC had only $ 85 million in reserve. The interesting general comment that one can make about the problems that faced OPIC, and without going into detail, was that here you had an agency

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which was striving to serve both its developmental and balance of payment responsibilities and as a result forgot about sound business practice so that what happened in 1970 was that OPIC found that one market accounted for over a quarter of its world wide insurance exposure, and I cannot help but feel that there is a lesson to be learned here for all of us.

With that brief aside, let us now return to closer at home, and comment on certain aspects of existing arrangements which are relevant and which must be borne in mind. Outside the fact that Ireland and Italy have no investment guarantee scheme, the existing arrangements have highlighted a serious weakness. Increasingly, as we know from our experience in multilateral supply contracts, large and medium size projects are undertaken by investors belonging to more than one Member State, but the definition of the nationality of the investor in the existing schemes completely lacks compatibility and it is argued that this is sufficient in and of itself to inhibit the possibility of encouraging the flow of new private direct investments to third countries which seems to be everybody's aim.

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At the time of the original negotiations of the Yaoundé Conventions, requests were made for the creation of a Community investment guarantee scheme. The question was raised unsuccessfully at the Hague Summit Conference in 1969, and again in a French memorandum dealing with the industrial policy of the Community in 1970. In fact, it was a Resolution of the Yaoundé Association Council which asked the Commission to study the problem together with a ~~Decision~~ request of the Permanent Representatives taken in 1971 which impelled the Commission to make a detailed study of this matter, and it would seem that other institutions of the EEC similarly pressed the Commission to work out Community instruments to encourage and protect private investments in developing countries. One way of tackling the problem would have been to harmonise existing systems and introduce this harmonisation system in those countries which had no investment guarantee schemes. However, since harmonisation in the export credit field has been going on for some thirteen years it was decided to avoid duplicating the slow and painful efforts which are continuing in the field of export credit insurance even now.

The Commission's Proposals were made in December 1972, and these contain three main characteristics.

First, the EEC scheme would complement Member States' schemes and would neither compete nor replace them. The argument used to justify this approach was that there were some investments which did not lend themselves to a Community guarantee and were better covered by Member States' schemes. Second, only joint investments by investors from two or more EEC member countries would be covered. Because of existing incompatibilities between the national schemes, it was felt that there was no danger that the EEC schemes would attract business from national schemes. Third, offers of covers would only be entertained if the proposed investments were deemed to be part of an efficient development policy.

It is therefore necessary to look at the other side of the coin for a minute, and look at the recipient countries' requirements as argued in the Commission paper. These requirements, it is argued, fall into

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three broad headings. The first, that investments must be approved by the host country although approval in and of itself is not a sufficient condition of eligibility under the EEC proposals. The second is that proper consideration must be given for the interests of the host country, and the third is that potential investments respond to the economic requirements of the host country.

Having decided that investment guarantees are desirable, how do you then set about creating circumstances which provide the best protection for these insured investments? There seems to be two schools of thought about this. The first says that you negotiate investment protection agreements and that you should only offer cover for investments in those countries who have signed such agreements. The second school of thought says that you would do better to insert guarantee clauses in trade agreements. Whether one is more effective than the other is, I suspect, impossible to say, and is certainly a matter of subjective judgement.

It has, however, become reasonably common for countries to conclude specific investment guarantee agreements. Under these agreements the

host country undertakes to afford foreign investments certain protection. Germany in particular, as I mentioned earlier on, favours the conclusion of treaties to protect overseas investments and has, I believe, concluded some eighteen treaties of this sort. France herself has entered into some 23 agreements on fundamental rights of citizens "friendship and commerce, economic relations or economic and financial cooperation with African Francophone states" and all these agreements concern in one way or another protection of overseas investments in Africa. Other countries have been very reluctant to use this type of agreement, and I believe that the United Kingdom has concluded very few of them although two specific examples spring to mind, one with Iran in 1959 and the other with the Cameroun in 1963.

What is the value of these agreements? Some people believe that the value is questionable and doubt whether they are essential for investments in developing countries, and it is interesting to notice that the German agreements are concluded with Asian and African states and not with Latin American countries, even though the weight of German investment is heavily focussed in Latin America, and as a matter of fact

The importance, in fact, of these agreements may well have been overrated because the states never bind themselves not to nationalise foreign investment but merely enumerate and specify certain rights which investors in many cases find little difficulty in being granted for each individual investment project, and I believe that I am correct in stating that their rights are in fact identical to those which they would have enjoyed under a specific investment agreement. It is true to say that a government's relations with a foreign investor are, insofar as compensation is involved, governed by international law and the investor therefore already enjoys certain rights securely under international law, although in the event of loss he may have to go through his own government to present a claim if his investment contract does not provide for arbitration. The most important element of investment guarantee schemes which concern compensation in the case of nationalisation are also embodied in international law, and it would therefore seem that investment guarantee agreements add little or nothing to what applies anyway. The only positive thing that can be said about investment guarantee agreements is that they are of importance to an investor not so much because of the

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protection that it obtains, but because the existence of such an agreement seems to be a pre-condition of insurance under certain national guarantee schemes.

I think it is interesting to note that the protection of private foreign investment under a multilateral convention is currently enjoyed under EEC treaties which provide for the freedom of establishment and non-discrimination in Member States, and applies equally if a state adheres to these treaties by association. The Yaoundé Convention itself, to which eighteen African states are parties, is based on such rules as are necessary for a customs union, such as the free circulation of workers, capital and goods, but it is important to stress that such rules in themselves may not be sufficient to grant full protection to investment ventures.

As a matter of fact, the Commission paper argues quite correctly that trade agreements of the Community countries are to be replaced by Community agreements following the Council Decision of 16th December 1969.

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It would therefore seem feasible for Community agreements to include a clause relating to investments. And the argument which seems to me to be sound is that the Community as a whole is stronger than its individual parts, and it is believed, therefore, that from a protective point of view this should be welcomed. The Commission proposes to cover non-commercial risks in the same way that the Member States do at present. These are war, expropriation, non-payment and non-transfer, inconvertibility and finally the exchange risk. Moreover, a variable premium rate structure is suggested.

You may well ask, given that we are already in November 1973, what has happened to the proposals which were issued in December 1972? There are, as you know, various institutions in the Community, and the intervening months have enabled the Economic and Social Committee to study the proposals in detail, and the Parliament has also studied the proposals in its Budget Committee and has raised certain problems which are in the process of being answered. In the meanwhile, some few meetings were devoted to discussing the Commission's proposals at the Coordination Group for Export Credit and Insurance Finance for Exports, and as yet no cohesive views have

emerged from this particular Group. One of the most important reasons for this is that with the accession of three new states to the Community on 1st January 1973 the first priority has been to dovetail existing export credit and financing systems so that the work done by the previous Six over the last thirteen years in this field should not be wasted. It is not that investment guarantees have been forgotten about, but that given the horrific amount of work to be done in export credits and given there are only so many hours in the day, the serious attention it deserves cannot be given to the Commission Proposals until at least Spring 1974.

Not being a crystal gazer, I cannot of course say what will emerge from the distillation of the wisdom of the interested underwriters involved in the nine Member States, but I can assure you that we are all determined to explore in detail the policy objectives which we are seeking to establish through the creation of a Community investment guarantee scheme.