European Communities Commission Background Report

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# EEC MAY INSURE FIRMS' STAKES IN THIRD WORLD

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The EEC Commission would be ready to offer insurance against 'non-commercial risks' to firms that invest in Third World countries. An outline of the main features of such a scheme is now before the Council awaiting approval. The idea has been sparked off in Brussels by the realisation that the world's future supplies of five essential minerals - cobalt, tin, phosphates, tungsten and copper - are now in jeopardy because of the reluctance of investors to risk their capital in the developing countries from which, as early as 1985, more than half the world's total needs may have to be drawn.

Investment in the developing countries would help to keep European industry abreast of competition from the United States and Japan and would benefit private firms, in addition to providing industry with dependable supplies of raw materials.

In 1961 - a mere seventeen years ago - European mining companies were spending 57 per cent of their exploration budget on prospecting in Third World countries. By 1973-1975 the proportion of their money allotted to the Third World had fallen to 13.5 per cent even though the geological prospects there were known to be more favourable.

"The main reason for stagnation of investment in this field is the difficulty faced by the mining companies and more especially 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," the Commission says in its memorandum to the Council.

Developing countries, the Commission points out 'sometimes resort to measures which are considered by investors as incompatible with the exercise of their business activities.' It adds: '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 exist mainly of creeping expropriation measures such as the gradual erosion of exploitation conditions, the 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

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investment'.

Neither national nor international protection schemes have so far proved adequate. National protection schemes, where they exist at all, often exclude certain sectors of industry, limit the insurance ceilings and sometimes take an arbitrary view of the risks involved or the importance of the proposed venture to the national economy. At international level, the impossibility of agreeing on guarantees for foreign investment was clearly shown in 1972 when the proposal put forward by the International Bank for Reconstruction and Development for an International Investment Insurance Agency foundered, mainly because of differences in political doctrine and business practices across the globe.

The Conference on International Economic Cooperation held in Paris last June showed how rapidly such differences can surface. Yet it is often desirable for investors of different nationalities to share the risks of joint enterprises in developing countries.

For this reason, and because it has been asked to take action by a European consortium of mining companies, the EEC Commission has drafted the outline of a scheme to protect capital invested in the Third World in projects involving companies from more than one Common Market state, and has asked the Council to approve the guidelines of its suggestions.

The Commission believes that two kinds of agreement are needed as safeguards. The first would be a general agreement between the EEC and individual developing countries - or groups of them - covering the basic rules for the treatment of foreign investment. It would set out the norms of good conduct both for host countries and investors. Conditions for investment in Third World countries would need to be both stable and 'transparent' (Community shorthand for 'without concealed evasions'). The general agreement would cover non-discrimination in the treatment of investment, equitable treatment of the investors' property, freedom of transfer of income and capital, compliance by investors with the laws of the host country and with the spirit of its development p programme, and procedures for settling disputes. Furthermore these general principles would form part of the Commission's brief for negotiating the new Lome II Convention as well as in further protocols for southern Mediterranean countries and in other cooperation agreements.

Apart from this the Commission recommends as its second safeguard individual agreements offering insurance guarantees for singly approved projects involving large capital (say investments of fifty million US dollars or more) by firms from at least two EEC member countries in a sector e.g. mining agreed as being of special importance to the Community.

For each project there would be (1) a three-way agreement between the investing firm, the Community authorities and the developing host country coupled with (2) an insurance guarantee offered by the Community to cover non-commercial risks to investments in developing countries.

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There might also be financial contributions from international organisations, as well as from the Community, towards selected projects.

Since the Community would be a party to both the general and the particular agreements, investors would feel assured that the Community authorities would be involved if a dispute arose out of an attempt by one side to alter the terms and conditions of the agreement.

The insurance guarantee to be negotiated between the firm or firms and the Community would cover war risks, restrictions on free transfers, expropriation, and any other unilateral modifications of the terms of the agreement in so far as these affected the viability of the investment. Firms seeking this insurance would be asked to pay a premium which could be based on the average of all the risks carried, or they could be adjusted to the risks of a particular sector, or of a particular project, and they would take account of the degree of cover required for the capital and profits, or losses.

The insurance scheme would normally be self-financing, and the chances of it not being so are considerably reduced because of the Community's participation. If, nevertheless, expenditure outran receipts, it would be necessary to look to the Community budget for the balance, under procedures and limits agreed in advance.

Any contributions from international financial organisations would act as an additional reassurance to investors to expand their activities in the Third World, the Commission believes.

The Commission is ready to consult business firms and insurance companies and to make specific proposals if the EEC Council gives approval.

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