

Jüttner, Heiner

Article — Digitized Version

Legal safeguards for direct investments in LDCs

Intereconomics

Suggested Citation: Jüttner, Heiner (1976) : Legal safeguards for direct investments in LDCs, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 11, Iss. 9, pp. 259-262, <https://doi.org/10.1007/BF02929069>

This Version is available at:

<https://hdl.handle.net/10419/139409>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Impact on the Host Countries' Trade Balances

The data of the same survey¹⁴ give some hints to how the DI activities of Japanese companies influence the trade balances of their host countries. The afore-mentioned surveyed affiliates in Asia registered in 1973 exports of Yen 394.0 bn and imports of Yen 508.2 bn thus causing a deficit of Yen 114.2 bn, that is about US \$ 0.42 bn for the whole region. They purchased on an average 51.1 p.c. of their inputs from Japan of which 43.0 p.c. came directly from the parent company. Local purchases account for only 41 p.c. on an average. The dependence of the affiliates on imports from Japan is especially high in Malaysia, Indonesia, Singapore, and South-Korea. It is comparatively low (about 40 p.c.) in the Philippines and Hong Kong.

¹⁴ op. cit., p. 171 ff.

The breakdown of the sales of the Japanese affiliates on the other hand shows that on an average 54.5 p.c. are sold in the respective domestic markets, 22 p.c. are exported to third countries and 23.7 p.c. are exported to Japan. In Thailand 88.1 p.c., in Indonesia 84.3 p.c., in Hong Kong 63.2 p.c., and in Malaysia 62.7 p.c. are sold in the national markets. In Singapore 50.9 p.c., Taiwan 54.6 p.c., and South-Korea 71.1 p.c. of the sales are exported either to Japan or to third countries. South-Korean affiliates direct 51.8 p.c. of their sales to Japan.

Since it can be expected that a comparatively high percentage of genuine foreign currency saving, that is "import substitution" type, DI are included in the domestic shares in sales, it remains undecided whether the Japanese DI really contribute to a deterioration rather than to an alleviation of the balance of payments deficits of the Asian DI countries.

Legal Safeguards for Direct Investments in LDCs

by Dr Heiner Jüttner, Aachen *

The developing countries are caught in the cleft stick of assertion of national interests and independence, on one side, and need for an improved investment climate to attract foreign direct investment, on the other. The question facing the foreign firms is how they can safeguard their capital investments against encroachment by the host country which may even expropriate their assets.

The German direct investments in less developed countries (LDCs) have doubled in the past five years; at the end of 1975 they amounted to DM 12.28 bn. The proportion of German investment capital placed abroad which went to the Third World has remained constant in this period; it was just under 30 p.c. The regional spread of the foreign investments did not change much either¹.

It appears from these figures that the distribution of the German direct investments over the various groups of countries and continents continues to be largely unaffected by international economic or political influences. Whether this will remain so in future is however in doubt because of the growing emphasis of the developing countries on

demands for full control over their natural resources and economic activities, including the right of expropriation.

What problems are bound to arise will be appreciated most clearly if one calls to mind the continuing efforts of the states of the Third World to attract large sums of foreign capital, and the related technical and commercial know-how, and the dilemma between assertion of their national sovereignty and improvement of the climate for investment which this involves.

Security the Aim of Business Firms

On the assumption — which is warranted on certain grounds — that business firms will in future still deem foreign investments to be necessary, especially in the developing countries, the possibilities of creating legal safeguards for such capital investments deserve particular attention, for

* Research Institute for International Technical-Economic Cooperation at the Rhenish-Westphalian College of Technology, Aachen.

¹ Cf. the external economic affairs circulars of the Federal Minister of Economic Affairs concerning property investments by residents in foreign economic territories.

the prime consideration for the business firms is that they should be able to operate without hindrance by state intervention and restraints and be sure of full control over their property. Their investment decisions depend not only on their commercial objectives (e.g. opening up of foreign markets, maximization of profits, expansion of sales, or safeguarding of raw material sources) but likewise upon the degree of certainty with which they can count on achieving these their objectives.

It is for this reason that guarantees concerning property and transfer rights always feature prominently among the government measures which business firms mention in enquiries about possible promotional measures by the state as being of importance for direct investments in LDCs. A survey by the World Bank and the International Chamber of Commerce for instance showed that 40 p.c. of the consulted firms regarded national guarantee systems as effective and that nearly half of them considered them an essential factor in investment decisions. 50 p.c. of the firms even stated that they had refrained from engaging in projects in developing countries or scaled them down because of the absence of an investment guarantee².

The importance of measures to cover the risks involved in direct investment in the Third World was also the subject of questions during the hearings of the German Parliamentary Committee for Economic Cooperation concerning "The activities and development-political influence of German multinational enterprises in developing countries" in Bonn in November 1974. All firms without exception stressed the need for such safeguards — more particularly in the case of capital investments by small and medium-sized firms and for investments in the least developed countries. Most of the firms regarded the guarantees and investment promotion treaties of the Federal Republic of Germany as an essential inducement for such investment activities of theirs.

Federal Guarantees as an Investment Incentive

The Federal Republic can provide guarantees to cover the political risk involved in capital investments abroad which warrant support if an investment promotion treaty or similar agreement exists between the Federal Republic and the foreign country in question or — in its absence — the legal order of the other country seems to provide adequate protection for the investment. Economic risks are not included in the Federal guarantees; covered are only nationalization, expropriation and

similar infringements; war, revolution, etc.; embargoes on payments and moratoria; and bans on currency conversion and transfers.

The guarantees run for 15 (exceptionally 20) years, and the annual insurance premium is 0.8 p.c. of the invested capital. The Federal authorities provide compensation for the value of the assets at the time and for any reinvested profits — if these are included in the insurance — up to 50 p.c. of the invested capital. The investor must bear himself at least 5 p.c. of the incurred loss.

German investors have to date insured themselves in this way for capital investments of a value of DM 1.765 bn, i.e. about 15 p.c. of all German direct investments in developing countries³. It thus appears that in these cases at least the business firms did not regard the safeguards provided for their investments by international agreements and national legislation as adequate. It can be inferred from the regional distribution of the guarantees where business firms see the greatest risks: In Africa (40 p.c.) and Latin America (30 p.c.) the proportion of insured investments was rather high in 1973, in Asia it was average, and in the European developing countries (10 p.c.) it was quite low.

Protection by Investment Promotion Treaties

Investment promotion treaties of the Federal Republic of Germany with developing countries are another means of providing a maximum of legal protection for capital investments abroad. 37 treaties of this kind are in force at present, including 23 with states in Africa, 10 in Asia and 2 each in Latin America and Europe. The treaties run for between 3 and 15 years and are extended automatically subject to a year's notice of termination. The protection then continues for another 5 to 20 years.

Essential features of the treaties are "equal treatment with indigenous firms", "most-favoured-nation treatment", protection against arbitrary expropriation, assurance of immediate, commensurate, effectively disposable and freely transferable compensation in the event of expropriation, and settlement of disputes by arbitration. They also provide guarantees for free transferability of earnings and proceeds from liquidation and disposal and for freedom of entry and employment for foreign specialists.

It is the purpose of the investment promotion treaties to enable the Federal Republic of Germany to intensify its economic cooperation with the partner countries, create favourable conditions

² Cf. International Bank for Reconstruction and Development (publ.), Multilateral Investment Insurance, Washington, D.C., 1962, p. 38 ff.

³ In October 1975; cf. Report on Development Policy by the Federal Government, Bonn, November 1975, p. 16.

for capital investment and stimulate private initiative by protecting the investments. The treaties also reduce the risk which the Federal Government incurs through the Federal guarantees for capital investments.

If the treaties were really to exercise a positive influence on the scope of the German direct investments in states of the Third World, they would also help to bring the Federal Republic of Germany nearer to its long acknowledged and pursued objective of channelling financial resources equal to 1 p.c. of the annual gross national product to the developing countries. The treaties may moreover enable the Federal Government to achieve closer political contacts by developing the economic relations.

The main motive for the developing countries concluding investment promotion treaties is the wish to increase their credit worthiness, strengthen confidence in their legal stability and thus make their countries more attractive to foreign investors. Moreover, the developing countries are aware that many industrialized states make the grant of investment guarantees – which are known to be in many cases an essential factor in investment decisions – conditional upon the existence of investment protection treaties or clauses.

The existence of an investment promotion treaty is of special importance for a business firm's decision if the investor is not yet committed to a particular location for his project. In this case he can check and compare the treaties with the relevant developing countries and note any variations or reservations as compared with the German model treaty.

The Judgment of Business Firms

German business firms however do not by any means think as highly of the investment promotion treaties as they do of the Federal guarantees against political risks. In a poll by the author only 8.6 p.c. of the consulted German firms singled out the treaties as measures for the promotion of direct investment in developing countries, while the guarantees were chosen by 23.6 p.c.⁴ The investment promotion treaties, it may be inferred, are unlikely to offer a significant inducement to make such investments. Statistical studies of the correlation between investment promotion treaties and investment activity have therefore also shown the treaties to result neither in a generally recognizable expansion of investment nor in increased direct investments in the treaty states⁵.

⁴ Cf. Heiner Jüttner, *Förderung und Schutz deutscher Direktinvestitionen in Entwicklungsländern* (Promotion and protection of German direct investments in developing countries), Baden-Baden 1975, p. 161.

⁵ *Ibid.*, p. 290-336.

In regard to the actual protective effect of investment promotion treaties the picture is different: No arbitration proceedings have as yet been initiated under investment promotion treaties, according to information from the Federal Ministry for Economic Affairs dated March 1976. The treaty guarantees have evidently been honoured by the partner states even though the treaty text had to be referred to occasionally. There were no treaties in existence (yet) when German capital was expropriated in Syria in 1964 and in Tanzania in 1967.

Promotion Measures by Developing Countries

Most important among the manifold measures for the encouragement of foreign capital investments by developing countries are legal provisions for protection against non-commercial risks, above all against infringement of property rights by the state. These guarantees which are contained in their statutory legislation, in development programmes and in treaties of establishment relate for the most part to fair treatment for the investment and protection against discrimination and arbitrary action by the state. Unqualified guarantees against expropriation or nationalization are given in some cases. In others there is only a guarantee that such measures are to be taken under certain conditions only – e.g. in the public interest and subject to appropriate, freely transferable compensation.

The guarantees and advantages promised to the investors apply as a rule only to direct investments expressly "authorized" by the developing country. The particular modes of procedure for such "authorization" allow the developing country to choose which direct investments and modalities for their encouragement are to be selected so as to influence the direction of investment activity. It is thus perfectly possible for "unauthorized" investments to exist side by side with those which have been authorized in this way⁶.

This special authorization involves mostly special conditions for the investor, e.g. in regard to capitalization, utilization of earnings, participation by local suppliers, production volume, duration of operations, employment of local labour and managerial staffs, or rights of control and cooperation for the host country. Investors tend to attach considerable importance to the guarantees offered by the developing countries. An enquiry by the author into the relevance of investment promotion measures by the developing countries showed that transfer guarantees and guarantees of property rights were with 29 and 22 p.c., respec-

⁶ Cf. Hans A. Havemann and Willy Kraus (ed.), *Handbuch der Entwicklungshilfe* (Development Aid Handbook), Loose-leaf collection, Baden-Baden 1974, II A 65 2 BR, p. 3.

tively, of all measures mentioned rated far more highly than tax allowances, preferential treatment of imports or financial assistance⁷. This underlines the importance of the element of security for direct investment in the Third World and at the same time shows that the business firms are keeping a critical eye on the investment legislation and economic law of the developing countries.

World Bank Convention on Arbitration for Disputes

There is another way in which developing countries can make their investment climate more attractive by providing greater legal protection, namely, accession to the "Agreement on the Settlement of Investment Disputes between States and Members of other States". The convention which bears this title was drawn up by the World Bank and put in force in 1966 and is designed for the settlement of disputes between an investment country and a foreign investor by uniform arbitration procedures. As many bilateral establishment and investment treaties as possible should for this purpose provide for reference of disputes to a World Bank arbitration centre. The investor should endeavour to have a clause inserted in any concession or establishment agreement with a host country to the effect that disputes are to be brought before the World Bank centre for the settlement of any differences.

A survey of the ICSID (International Centre for Settlement of Investment Disputes) of February 1976 – which is incomplete because disputes are not notifiable – listed already 27 bilateral agreements between industrialized and developing countries as well as 11 national acts of legislation which contain a reference to the World Bank convention. How many agreements between states and private firms contain clauses of this kind is not known.

The convention had by the middle of 1975 been signed by 71 and ratified by 66 states. An investment dispute was submitted to the centre for the first time at the end of 1971; by 1975 four more cases had been submitted. No judgments have yet been given; decisions may be published only with the consent of both parties⁸. German investors have not been involved in any of the investment disputes to date.

This World Bank convention may be regarded as an important contribution to the establishment of uniform international arbitration and thus to the promotion of foreign investment activities. It

constitutes, moreover, an advance on the general international law insofar as it allows access to international arbitration also to individuals. The importance of the convention may be gauged from the fact that the various efforts to achieve a multi-national investment protection agreement and an international investment insurance system have so far come to nothing.

That – in addition to the East Bloc states which are not members of the World Bank group or the International Monetary Fund – the Latin American states have kept away from the World Bank convention no doubt limits its area of effectiveness. The attitude of these countries is determined by the so-called Calvo Doctrine which does not permit the grant to foreigners of greater rights than are available to citizens and thus rules out appeals to international arbitration courts. As India has likewise stayed outside the convention, it must be said that the developing countries with the largest proportion of foreign investments have in fact turned their back upon the convention.

Security by Self-Action

Irrespective of efforts for increased protection of capital investments in other countries on the national and international scale, investors can themselves help to improve the security of their investments. They can for instance counter prejudices and fears of foreign domination by adapting their conduct to the ideas of the developing countries, as has been suggested in the guidelines of the International Chamber of Commerce⁹. Employment of local managerial personnel, ready and comprehensive information about their business and an appropriate rate of profit reinvestment may be mentioned in this context.

Joint ventures with local interests are an especially suitable means of providing greater legal security. Not only can these help the foreign investor to gain a better insight into the particular social, legal and administrative situation in the host country with which he is often insufficiently acquainted, but in most cases they tend to lessen the risk of state encroachment or even expropriation. Participation by local development banks or other institutions of the developing country has proved an effective protective device. Joint capital investments with public agencies outside the developing country such as the German Development Corporation (DEG) or – on the international level – the International Finance Corporation (IFC) are in a similar position¹⁰.

⁷ Cf. Heiner Jüttner, *ibid.*, p. 161.

⁸ Cf. International Centre for Settlement of Investment Disputes (publ.), Ninth Annual Report 1974/75, Washington, D.C., 1975, p. 4 ff.

⁹ International Chamber of Commerce (publ.), Guidelines for Foreign Investments, Cologne 1972.

¹⁰ Cf. Ignaz Seidl-Hohenveldern, *Investitionen in Entwicklungsländern und das Völkerrecht* (Investments in developing countries and the international law), Cologne-Berlin-Bonn-Munich 1963, p. 59 f.