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**Research Report**

## The limits of capacity building for investment contract negotiations

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Perspectives on topical foreign direct investment issues

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### **The limits of capacity building for investment contract negotiations**

by

Karl P. Sauvant, Vanessa S. W. Tsang and Louis T. Wells\*

Developing countries must negotiate the best possible investment contracts with foreign investors at the outset. Contracts determine the obligations of host countries and investors and the distribution of benefits between them for years to come.

Contracts for mining and infrastructure can be highly complex, involving specialized technical agreements. Their subjects range from the division of revenue to financing, pricing, construction, operating obligations, environmental commitments, and responsibilities at eventual closure. Developing countries rarely have the expertise in all these fields to match that available to international investors.

The results of negotiations are, therefore, often sub-optimal for host countries. At one time, initial contracts could relatively easily be renegotiated. Today, the availability of investor-state dispute settlement (international arbitration) makes it [difficult to change](#) contracts once they are concluded, hence the importance of getting deals [right at the outset](#).

Donor organizations regularly push for “capacity building” to create technical expertise for negotiations within host country governments. That expertise can cover financial analysis, industry knowledge, engineering and geological evaluation, environmental analysis, legal expertise, regulatory skills, and more. But building and maintaining technical expertise within a government is a time-intensive and costly undertaking, and it often fails.

Does it make sense to try to build all these technical skills within a government? Experience suggests caution:

- Many countries negotiate contracts of a particular type only sporadically. The cost of building and maintaining all the necessary skills in-house may not be justified.
- Retaining the skills is often difficult. Better salaries in the private sector, at home and abroad, attract trained professionals away from government. Although many officials may not be moved by better offers, loss of skilled personnel to the private sector or international institutions is frequent.
- Even those who remain in government are, in many cases, rotated away from the positions in which their skills are needed.
- Deep expertise is built from experience over many years. Keeping expertise up-to-date requires regular engagement in practice, but frequent use is often uncommon in government.
- Even when countries have sectoral ministries (e.g., ministries of mines or infrastructure) and state-owned technical agencies that possess some of the needed technical expertise, tensions between government entities may make it difficult to draw on them for negotiations.
- Few “capacity building” attempts actually build much capacity. To be effective, they are best organized and supervised by specialized entities that can create pedagogically sensible syllabuses, call on materials developed for teaching purposes and bring instructors who encourage exchanges among participants. Simply organizing a chain of presentations by experts is not likely to be effective. An hour or even a day of lecture on building financial models cannot make an official capable of constructing useful models. At best, it can convey a sense of skills that are lacking.
- Investors do not attempt to develop all expertise they need in-house. They bring in outside legal experts for mergers and acquisitions and international arbitrations, and they hire engineering consulting firms for designing or valuing projects. If the skills are needed only infrequently, they are best hired from outside.

Of course, building certain technical expertise internally may be worthwhile for governments that negotiate particular types of investment contracts regularly. For this purpose, some governments build organizational structures to retain experts. State-owned enterprises are one possibly effective instrument because they can offer better salaries and advancement opportunities.

But for most sectors, most developing countries—and especially the least developed ones—cannot rely solely on in-house technical expertise to negotiate investment contracts.

There is, however, room for *broader* capacity building programs. In most cases, they are likely to be more effective if they aim at tasks that are broadly useful:

- How to identify and arrive at clear government objectives and what negotiation strategy to pursue, to provide overall guidance to technical advisors and identify what kind of technical expertise is required for the actual negotiations.
- How to assemble a multidisciplinary negotiation team that is best suited for a particular project, with an appropriate mix of local and international advisors.
- How and where to obtain outside advice.
- Which contract clauses and key issues require special attention during negotiations.
- How to monitor the implementation of contracts.

Fortunately, when developing countries need specialized technical skills that are not available in house, they—like investors—have the option of seeking world-class international support for negotiations. Such support is [available](#) free of charge to developing country governments from a number of organizations.

In sum, there is room for programs to build capacity for investment contract negotiations, but those that focus on technical capacity fail to accomplish much under most conditions. Similarly, one should not expect that an organization that provides technical assistance would be effective in mounting teaching programs. However, advisors should be charged with encouraging as much “learning-by-doing” as possible while they are assisting in negotiations.

Donors should recognize these limits and, therefore, fund organizations that provide direct negotiations support and focus on capacity building of the kind described above. Together, these kinds of support can improve the outcomes of investment contract negotiations.

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