Dávid R., Neckář J., Sehnálek D., (Editors). COFOLA 2009: the Conference Proceedings, 1. edition. Brno : Masaryk University, 2009, ISBN 978-80-210-4821-8

CURRENT ISSUES OF INVESTING IN DEVELOPING COUNTRIES

ROMAN KALIŠ

Fakulty of Law, Masaryk University, Department of International and European Law, Czech Republic

Abstract in original language:
Přestože mnoho rozvojových zemí disponuje velkým investičním potenciálem, příliv zahraničních investic na jejich území neroste. Právě probíhající světová ekonomická krize by mohla být nejjednodušším vysvětlením této skutečnosti. V době kdy velké finanční instituce, nadnárodní společnosti a dokonce i některé státy bojují o „přežití", pohyb mezinárodního kapitálu nemůže zůstat nedotčen. Ekonomická krize však ve většině případů není hlavn9m důvodem stagnace přílivu mezinárodních investic do rozvojových zemí.

Key words in original language:
Mezinárodní investice; rozvojové v. rozvinuté země; světová ekonomická krize; ochrana zahraničních investic.

Abstract:
In spite of the fact that many developing countries have beyond any doubt a big investment potential, the inflow of foreign investments is not growing. These countries are turning to the biggest world economies and ask why the inflow of foreign direct investment from developed countries is stagnating. The current global economic crisis can be one reason and most likely would be the easiest explanation. At the height of global economic crisis when large financial institutions, multinational companies and even governments are struggling, the transfer of international investment cannot stay unaffected. Nevertheless, the economic crisis is not the main reason in most cases.

Key words:
International investments; developing v. developed countries; global economic crisis; protection of foreign investments.

INTRODUCTION

Foreign trade and investment could be the major driving force for developing countries.[1]It can help to attain higher and more sustainable economic growth rates through supporting economy modernization and its structural adjustment, creating employment, providing more opportunities for domestic private sector, facilitating competition, transferring skills, knowledge and technology, etc[2]. It is obvious that there is a great need to promote foreign

---

[1] „There is a widespread consensus on the importance of foreign direct investment to developing state". Bayzakova, D., Zarafshan – Newmont Case and International Investment Arbitration against Uzbekistan: Interpretation of Consent by the Host State and Relevance of National Legislation. Journal of World Investment and Trade.

[2]UNDP; Capacity Building and Strenghtening Foreign Trade in Investment Promotion Institutions in Uzbekistan

trade and at the same time attract foreign investments in developing world. In spite of the fact that many developing countries have beyond any doubt a big investment potential, the inflow of foreign investments is not growing. These countries are turning to the biggest world economies and ask why the inflow of foreign direct investments from developed countries is stagnating. The current global economic crisis can be one reason and most likely would be the easiest explanation. At the height of global economic crisis when large financial institutions, multinational companies and even governments are struggling, the transfer of international investment cannot stay unaffected. Investment budgets of many multinational companies are cut and they are therefore lacking funds to invest abroad. Nevertheless, the economic crisis is not the main reason in most cases. The investors who have the investments funds available at the moment have realized that the cost of many investment opportunities is decreasing and that the crisis can be actually the best time to invest their capital with the view of high profits in the future[3]. International investors are however not willing to invest in a foreign territory unless they feel their investment is dully protected against non-commercial risks usually in form of a state’s expropriatory or other actions with similar effect that could harm their property.

1. INTERNATIONAL INVESTING

The transfer of cross-border investments has become a daily reality of today’s more and more globalized world. In order to promote international investment exchange, the states insist on mutual facilitation of transfer of international capital and are trying to take all advantages connected with the inflow of foreign investments. For developing countries, the placement of foreign investment in their territories does not mean only acquiring financial capital, but also an opportunity to strengthen the stagnating economy, acquiring the latest foreign technologies, decreasing unemployment, as well as raising the qualification of the laborers and managers employed by foreign companies[4]. Foreign trade and investment could thus be the major driving force for developing countries[5], which would help to attain higher and more sustainable economic growth rates through supporting economy modernization and its structural adjustment, creating employment, providing more opportunities for domestic private sector, facilitating competition, transferring skills, knowledge and technology, etc[6].

The advantages for foreign investors then lie especially in the opportunity to use cheaper labor force[7] in the host state, opportunity to enter new markets and also getting an access to

---

[3] For instance the cost of real estate property as well as other investment opportunities in European Union and America is decreasing and the volume of Chinese invesments in Europe is rapidly growing every year, on the other hand the volume of European investments in China is decreasing.

[4] „For transitional economies foreign direct investments (FDI) has a special significance as it can accelerate the modernization of their economies not only through capital inflows but also through the transfer of technology and business and management skills“. UNDP, *Investment Guide to Uzbekistan*, 2007

[5] „There is a widespread consensus on the importance of foreign direct investment to developing state“. Bayzakova, D., *Zarafshan – Newmont* Case and International Investment Arbitration against Uzbekistan: Interpretation of Consent by the Host State and Relevance of National Legislation

[6]UNDP; Capacity Building and Strenghtening Foreign Trade in Investment Promotion Institutions in Uzbekistan

[7] At the time of global economic crisis many workers from developing countries working abroad (usually in the European Union and United States) were laid off and returned to their home coutries where they also stayed

natural resources which are not available in their home countries. The foreign investors, however, don't feel comfortable to invest in a foreign territory, unless they feel that their investment is sufficiently protected against political risks. One of the indispensable conditions for attracting foreign investments is therefore the creation of favorable legal environment in the host state. In order to stimulate international investing, the states are usually concluding bilateral investment treaties[8], accessing to multilateral treaties[9] dealing with international investment protection and passing national legislation aimed at protection and promotion of foreign investments. Any country should however bear in mind at all times that the sole acceptance of international obligation in form of an international treaty or by passing national investment legislation, is not sufficient and that the protection embodied in these legal acts has to be effectively promoted in practice. The host country has thus the important duty to guarantee an appropriate protection of foreign investors property placed at the host state's territory. Such protection currently lies especially in providing foreign investor with such treatment as is guaranteed by investment treaties and investment legislation. Breach of these obligations leads to international responsibility of the host state and creates an investor's right to claim compensation at a national court or agreed arbitral tribunal[10]. The cost of such a breach may then be very high.

2. INVESTING IN DEVELOPING WORLD

One of the biggest problem foreign investors usually face in developing countries is the legal uncertainty caused by high frequency of investment legislation's changes[11]. To deal with this issue, the national investment legislation sometimes introduces so called "grandfather clause" which gives the foreign investor the right to opt out of any piece of legislation passed after the entrance of the concerned investment to the territory of the host state which "impairs the conditions of investing."[12] If the investment is made based on an "investment contract" concluded between the international investor and the host government, it is also highly recommended to include a stabilization clause in this contract which freezes the legal regime to the date when the international investment was placed in the host-country. The stabilization clause has got similar effect as the grandfather clause provided for by the national investment legislation and renders all adverse legislative changes inapplicable to the international investment in question. However, the foreign investors are often in reality not able to take

---

unemployed. The foreign investors who are ready to invest in a devoping country can now take advantage of employing well educated local laborers and managers with the experience working abroad.

[8] So called „Bilateral treaties on reciprocal encouragement and protection of foreign investments".

[9] International Convention on Settlement of Investment Disputes between States and Nationals of Other States (the Washington Treaty), The Soul Treaty on Multilateral Investment Guarantees Agency, Energy Charter Treaty.

[10] As was for instance the case in C.M.E. v the Czech Republic (2002) in which the Czech Republic was found in breach of investment treaty treatment standards and had to pay compensation of about USD 300 milion.

[11] „A primary complaint of foreign investors was the legal uncertainty caused by the remarkable frequency with which the Uzbek government adopted new laws and repeals old ones." Newman, A., *Investing in Uzbekistan: A Rough Ride on the Silk Road*. 30 Law & Pol'y Int'l Bus. 1998-1999

[12] Article 11 of 1994 Foreign Investment Law

advantage of these provisions because the negative effect of any subsequent legislation is to be determined by the host state's national authorities themselves whose objectivity is (at least) controversial[13].

Another "hot" issue the international investors keep complaining about is the restrictions the host states place on repatriation of profits. The national legislation usually proclaims the right of investors to freely transfer his hard currency income to and from the host country. In the next sentence it can however introduce an additional condition saying that this right exists pursuant to the host state's national legislation. Such provision again gives the national authorities a great amount of discretion to restrict the freedom of profit repatriation basically at any time. International investors has to realize and be aware of the fact that immediate transfer of hard currency capital is not going to be possible due to pertaining problem with hard currency conversion and that the conversion and transfer of hard currency profit out of the country is in reality not as simple and can last for several months or even longer. As can be implied from this fact and as was already mentioned above, the conversion and following repatriation of profit can be very burdensome.

CONCLUSION

As I have already noted above, the ongoing global economic crisis is not of the biggest concern for an investor thinking about investing in a developing country. The main problem persists to be the legal uncertainty often created by the host state's legislation as well as insufficient observance of international obligations providing for protection of international investments. The solution is not a difficult one. Any host state which seeks to attract foreign investor should honor investment treaties it has concluded and at the same time put stress on keeping promises it has given to the investors in national legislation to encourage them to invest on its territory. It is important to realize that the breaches of any such obligation will most likely lead to an international arbitration and if the host state is found guilty of breaching international investor's rights the price will be very expensive. Moreover, the punishment does not take only the financial form of compensating investor's loses but also harms the host state's prestige in international arena which will make it less attractive for any potential investor in the future.

Literature:

- Baker & McKenenzie, Doing Business in Uzbekistan 2008
- Bayzakova, D.: *Zarafshan – Newmont* Case and International Investment Arbitration against Uzbekistan: Interpretation of Consent by the Host State and Relevance of National Legislation. Journal of World Investment and Trade, 6/10/2008
- Kalis, R.: Legal Environment for International Investments in Uzbekistan, Masaryk University, Cofola 2008

[13] As can be implied from this fact, there has been a great scope of discretion on part of the authorities and their objectivity was unfortunately doubtful.

- Newman, A., Investing in Uzbekistan: A Rough Ride on the Silk Road. 30 Law & Pol'y Int'l Bus. 1998-1999
- PriceWaterHouseCoopers, Uzbekistan Doing Business Guide, 2008-2009
- UNCTAD, The Global Economic Crisis: Systematic Failures and Multilateral Remedies. United Nations 2009
- UNDP, Capacity Building and Strenghtening Foreign Trade in Investment Promotion Institutions in Uzbekistan.2007

Reviewer:
Naděžda Rozehnalová

Contact – email:
romankalis@seznam.cz