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THE FOURTEENTH PLENARY SESSION OF THE PABSEC GENERAL ASSEMBLY

THE ECONOMIC, COMMERCIAL, TECHNOLOGICAL AND ENVIRONMENTAL AFFAIRS COMMITTEE

# REPORT

ON

## "PROMOTION AND PROTECTION OF INVESTMENTS IN THE BLACK SEA REGION"

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## A. INTRODUCTION

1. Foreign Direct Investment (FDI) is investment carried out with the aim of acquiring a lasting interest in an enterprise operating in another country (the host country), the purpose of which is to give the investor an effective voice in the management of the enterprise or a substantial interest in its business. This may be done through the establishment of an entirely new firm or through the purchase of an existing firm.

2. The contribution of foreign investment to economic growth and development is now widely recognised. Although reaping the full benefits of foreign investment depends on many factors including the policy environment of host countries, foreign investment brings capital and know-how, creates higher quality jobs and increases domestic productivity. FDI can raise social and environmental standards when accompanied by appropriate government policies and responsible behaviour by enterprises.

3. Despite the benefits and importance of foreign investment, which has been growing faster than trade and is central to countries' integration into the global economy, adequate multilateral investment rules are still lacking. International rules have much to contribute to the stability of the multilateral system and in promoting greater and more stable investment flows, higher quality investments and a better distribution of their benefits.

4. Adherence to rules may be especially valuable to countries whose share of international investment falls short of their needs, as are the majority of the BSEC countries, as well as to small and medium-sized enterprises that might otherwise hesitate to invest outside familiar territory. Rules offer transparency and predictability for investors, and a vehicle for international co-operation and dispute resolution. These benefits flow to all countries, regardless of size and regardless of whether they are capital exporting or importing countries.

5. For the drafting of this Report the International Secretariat received the contributions of Armenia, Greece, Moldova, Romania, the Russian Federation and Turkey.

6. It should be noted here that the Report is complementary to the Report on "Trade Development in the Black Sea Region" (Doc. GA 6492/99), which deals more extensively with the macro-economic policy issues relevant to trade and investment.

## B. GENERAL WORLD DEVELOPMENTS IN INVESTMENTS

7. The case for opening markets to foreign direct investment is as compelling as it is for trade. More open economies enjoy higher rates of private investment, which is a major determinant of economic growth and job creation. FDI is actively courted by countries, not least because it generates spillovers such as improved management and better technology.

8. International flows of FDI (as opposed to short-term capital movements) have increased significantly since the mid-1980s, totalling USD 52 billion in 1980, but rising to USD 350 billion in 1996. This growth has allowed firms greater access to capital to finance further development and expand their operations at home and abroad. Developing countries and economies in transition have been major recipients of international FDI in recent years. More than one third of world FDI currently goes to developing countries compared to barely one fifth in the first half of the 1980s. Global flows of foreign investment have overtaken world exports. Nevertheless, the distribution of FDI is concentrated in a small number of developing countries with ten recipients accounting for 88% of all FDI flows to developing countries in 1994.

9. The potential gains from FDI for a host country include job creation, access to foreign markets through the transnational corporation network, access to modern technology, access to skills, managerial and organisational practices, reduction of imports by local

production, stimulation of domestic enterprises in the provision of goods/services needed by the foreign investor. In addition, there is also the beneficial effects of the presence of foreign firms on domestic enterprises productivity and competitiveness. There is also room for foreign investment in host countries' infrastructure and in the privatisation process, both areas requiring substantial capital and technological investments, which is particularly beneficial to developing countries.

10. FDI serves all countries, including the home country of an investor. It enables firms to spread risk over world markets and remain competitive across the range of their activities. It also opens up new opportunities, particularly in services, where being established in a specific country is the only way to win a satisfactory share of foreign business there. That's why investment and trade flows go hand in hand.

11. The benefits are tangible. A study of the countries of the Organisation for Economic Cooperation and Development found that each $1.00 of outward foreign direct investment was associated with $2.00 of additional exports, and a trade surplus of $1.70. Without FDI those exports would be smaller, sustaining fewer of the more productive, better paying jobs that go with them.

12. Liberalisation can benefit developed and developing countries alike. As is the case for OECD countries, foreign investment brings higher wages, and is a major source of technology transfer and managerial skills in host transition or developing countries. This contributes to rising prosperity in the countries concerned, as well as enhancing demand for higher value-added exports from richer Western economies. In this way, developing countries are becoming major stake-holders in the trading system today, as is evidenced by estimates that close to one half of Uruguay Round welfare gains may accrue to them.

13. Moreover foreign direct investment is a major vehicle for developing a strong, dynamic private sector. It is essential to ensure successful transition to a market-based economic system and integration into the world market. Strategic foreign investors not only bring debt-free capital but also know-how, technology and access to foreign markets.

14. In a more integrated and globalised world economy, marked by a close interlinkage between trade and foreign direct investment, other impediments related to domestic policies and regulatory regimes are progressively becoming more important. These structural barriers, susceptible to distort markets, include for example state aids, taxation policy, government procurement modalities, telecommunication regimes or anti-competitive business practices.

## C. INTERNATIONAL LEGAL FRAMEWORKS ON INVESTMENT

15. Bilateral Investment Treaties are the main framework within which FDI has taken place so far. But they lack uniformity and do not address wider issues such as environmental protection or sustainable development. Multilateral rules concerning investment today are also partial in the issues that they address. Important World Trade Organisation (WTO) agreements having an impact on FDI include the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Investment Measures (TRIMs).

16. A number of initiatives have been attempted to draw up a more complete multilateral framework. The most ambitious to date is the negotiation of a Multilateral Agreement on Investment (MAI) within the framework of the Organisation for Economic Cooperation and Development (OECD). The WTO Working Group on Trade and Investment as well as the United Nations Conference on Trade and Development (UNCTAD) are also examining the issues.

### 1. The BSEC

17. The BSEC Ministers of Foreign Affairs adopted from a very early stage, on 25 October 1996 in Moscow, the *“Basic Principles of Investment Collaboration in the BSEC Region”.* We will mention them in Chapter E- General Recommendations.

**2. The World Trade Organisation**

18. Work in the WTO on investment and competition policy issues so far has largely taken the form of specific responses to specific trade policy issues, rather than a look at the broad picture. New decisions reached at the 1996 ministerial conference in Singapore change the perspective. The ministers decided to set up two working groups to look more generally at the relationships between trade, on the one hand, and investment and competition policies, on the other.

19. An indication of how closely trade is linked with investment is the fact that about one-third of the $6.1 trillion total for world trade in goods and services in 1995 was trade within companies - for example between subsidiaries in different countries or between a subsidiary and its headquarters.

20. The close relationships between trade and investment and competition policy have long been recognised. One of the intentions, when the General Agreement on Tariffs and Trade (the GATT) was drafted in the late 1940s, was for rules on investment and competition policy to exist alongside those for trade in goods.

21. Over the years, GATT and the WTO have increasingly dealt with specific aspects of the relationships. For example, one type of trade covered by the General Agreement on Trade in Services (GATS) is the supply of services by a foreign company setting up operations in a host country - i.e. through foreign investment. The Trade-Related Investment Measures Agreement says investors' right to use imported goods as inputs should not depend on their export performance.

22. The same goes for competition policy. GATT and GATS contain rules on monopolies and exclusive service suppliers. The principles have been elaborated considerably in the rules and commitments on telecommunications. The agreements on intellectual property and services both recognise governments' rights to act against anti-competitive practices, and their rights to work together to limit these practices.

23. The Agreement on Trade-Related Investment Measures (TRIMS) applies only to measures that affect trade in goods. It recognises that certain measures can restrict and distort trade, and states that no member shall apply any measure that discriminates against foreigners or foreign products (i.e. violates "national treatment" principles in GATT). It also outlaws investment measures that lead to restrictions in quantities (violating another principle in GATT).

24. An illustrative list of TRIMS agreed to be inconsistent with these GATT articles is appended to the agreement. The list includes measures which require particular levels of local procurement by an enterprise ("local content requirements"). It also discourages measures which limit a company's imports or set targets for the company to export ("trade balancing requirements").

25. Under the agreement, countries must inform the WTO and fellow-members of all investment measures that do not conform with the agreement. The agreement establishes a Committee on TRIMS to monitor the implementation of these commitments. The agreement also says that WTO members should consider, by 1 January 2000, whether there should also be provisions on investment policy and competition policy.

### 3. The European Union

26. The European Union institutions have during the last years expressed the belief that the time has come for the WTO to establish a multilateral framework of rules governing international investment, with the objective of securing a stable and predictable climate for Foreign Direct Investment (FDI) world-wide. Notwithstanding the difficulty of drawing precise distinctions in this area, such a framework should focus on FDI, to the exclusion of short-term capital movements.

27. Moreover, it should preserve the ability of host countries to regulate the activity of investors (whether foreign or domestic) on their respective territory, taking also into account the concerns expressed by civil society in many WTO Members, including those regarding investors' responsibilities. The Commission proposed some months ago to the Council of Ministers the adoption of a Council Regulation concerning the provision of assistance to economic reform and recovery in the New Independent States and Mongolia. Amongst its articles, the article on Investment Promotion stipulates the following:

28. An important percentage of the annual budgetary allocation shall be used to support investment. This assistance shall take the following forms:

- technical assistance in support of the enabling framework;
- technical assistance to catalyse or accompany investment either before or during the investment;
- co-financing with other sources of investment financing or, on an exceptional basis, investing alone.

29. Priority sectors for investment financing would include: cross-border cooperation, border infrastructure, promotion of SMEs, environmental infrastructure and networks.

30. The European Union has undertaken several efforts to help promote FDI in the in the New Independent States (NIS). Firstly, the European Union has significantly increased its commitment towards the funding of investment support for EU-NIS small and medium-sized enterprise joint ventures and for small-scale infrastructure projects in border areas.

31. The European Union extended its JOP facility to the NIS in 1996. The aim of the Joint Venture Programme (JOP) is to facilitate productive European Union investment in the NIS. By encouraging cooperation between partners located in the EU with partners in the NIS, the EU contributes to the efforts of the NIS towards developing productive investment and a market economy aimed at promoting inter-state, inter-regional and cross-border cooperation, including small infrastructure projects in cross-border areas.

32. Last but not least the Partnership and Cooperation Agreements, signed with Azerbaijan, Armenia, Georgia, Moldova, Russian Federation and Ukraine, will offer greater security to companies and investors from the EU, and thus encourage the direct investment which is needed by the economies.

### 4. Organisation for Economic Cooperation and Development

33. In 1995, OECD Ministers launched negotiations on a multilateral agreement on investment (MAI) with high standards of liberalisation and investment protection, with effective dispute settlement procedures, and open to non-members. Significant progress towards this goal has been achieved.

34. Over the past three years, OECD member countries engaged in negotiations on a Multilateral Agreement on Investment, designed as a stand-alone agreement open to non-members. Progress reports were made regularly and a draft consolidated text and

commentary was made available in April 1998. A period of consultation and assessment occurred last year.

35. The MAI will be the first international agreement combining legally binding obligations to reduce restrictions on international investment with legal guarantees for protecting investments and dispute settlement.

36. The MAI will not eliminate all barriers to foreign investment. Any country will be able to take measures necessary to protect its national security or to ensure the integrity and stability of its financial system. Temporary safeguard provisions will enable countries to take measures necessary to respond to a balance of payments crisis. Country specific exceptions, negotiated among MAI Parties, will permit each country to maintain non-conforming laws and regulations The MAI will not mandate detailed domestic measures affecting investment, nor require member countries to adopt a uniform set of investment regulations. It will not prevent Parties from providing funds for domestic policy purposes, nor will it require Parties to accept each others' product or service quality or safety standards.

37. Significantly the MAI will be open to accession by non-OECD Member countries that are willing and able to meet its obligations. In addition to the 29 OECD Member countries and the European Union, eight countries participate in the negotiations as observers.

## D. CONTRIBUTIONS OF THE MEMBER COUNTRIES

### Armenia

38. Armenia has concluded bilateral agreements on protection of investments with Bulgaria, Georgia, Greece, Romania and Ukraine. In total Armenia has similar agreements with 17 states, while another 22 agreements are under way.

39. Apart of it, the country joined the "Convention on protection of the investors' rights", signed by the CIS member-countries on 28 March 1997. In the nearest future Armenia is going to join the "International Convention on Settlement of Investments Disputes" and to get access to the services of the International Centre for Settlement of the Investment Disputes (ICSID).

40. The current legislation of Armenia stipulates an “open door policy” regarding foreign investments. The legislation also stipulates equal conditions for foreign and domestic investors alike, limits the right of the state in property alienation and demands full compensation to be given for the alienated property on behalf of the state, opens almost all sectors to the economy to foreign investment, guarantees five years protection of investments in any changes of legislation if they result in deterioration of the conditions for investors, and establishes domestic and international arbitration, as well as protection of intellectual property.

41. The total value of all direct foreign investments in Armenia in 1988-98 was approximately 365 million USD, the most of it being invested into its economy in the last two years. The biggest investors are Greece, Russian Federation, Iran, USA, France, United Kingdom, Canada, Germany, and Syria

42. According to official statistics, in the period between 1988 up to January 1999 about 1350 enterprises were set up on the basis of foreign investments, most of them being registered in the last three years. Most of the enterprises with foreign capital were set up by investors from Russia, Iran, USA and France, the countries with big Armenian communities. There are also some BSEC member countries among them: Russia, Georgia and Bulgaria. The Greek OTE company, one of the biggest investors in the field of telecommunication in the Republic (90% shares of "Armentel"), will invest about 300

million US dollars in to development of telecommunication in Armenia, which is one of the basic conditions of the deal.

43. According to the Government of the Republic of Armenia, big investments in the amount of 1,2 billion USD are expected to be made in the next three years through new investments, re-investments and privatisation of big state enterprises, including hotels. Joint-ventures and private foreign companies in the last three years were mainly involved into foreign trade, but now much more investments are being made into small and medium business.

44. Armenia believes in the need to start preparations of a BSEC multilateral agreement for promotion and protection of foreign investment, as a step towards a BSEC common market. Additionally the country proposes the setting up of mechanisms of information exchange in the field of foreign investments protection.

**Greece**

45. The country sees its fellow BSEC countries as historically traditional commercial partners. Although the BSEC countries have rich natural resources, huge industrial infrastructure, and a very well educated and specialised labour force, there is a number of problems that hamper trade expansion. These problems have to be gradually tackled, in order to positively influence Greece’s trade relations with its BSEC partner countries:

- structural inefficiencies and production of goods with limited export potential;
- instability in the political system;
- inadequate legal framework pertaining trade and investments and lack of transparency in the respective rules and regulations;
- insufficient transport and telecom network, as well as banking system;
- protectionism in a large number of goods and services, and;
- low income level, influencing consumer purchasing power.

46. Greece has concluded agreements on the avoidance of double taxation with Albania, Armenia, Bulgaria, Georgia, Romania, Russia and Ukraine.

**Moldova**

47. The Republic of Moldova has concluded bilateral agreements on mutual promotion and protection of investments with 26 states, including Azerbaijan, Bulgaria, Georgia, Greece, Romania, Russia, Turkey and Ukraine, and proposes the conclusion of a similar multilateral agreement between all PABSEC member states. The Republic of Moldova has bilateral agreements in the field of trade and economic cooperation with 22 states including Bulgaria, Greece, Russia, Turkey and Ukraine. It has also concluded bilateral agreements on avoidance of double taxation with 19 states, including 6 BSEC states. Free trade agreements have been concluded with all CIS member states, and with Romania. From January 1996 the Republic of Moldova has obtained the observer status at the WTO and is presently on its way to become a full member of the organisation. The Republic of Moldova is undertaking measures to create a proper investment climate for foreign investors and is open for foreign investments in all branches of economy, having a very qualified labour force and a large potential for investments, especially in the fields of food and light industry, equipment manufacturing for agriculture and food industry, pharmaceuticals, biotechnology, energy, telecommunications, construction materials, electronics etc. A considerable part of these domains is oriented to the export sector, the priority given to the CIS states, Eastern Europe and the Western countries.

**Romania**

48. Making an investment in Romania, as well as the possession, use or disposal of a property are guaranteed and may not be the object of any discriminatory measures. Also,

the administration, maintenance, use, extension or elimination of an investment may not be the object of discrimination.

49. In Romania the foreign investors have a national treatment and they benefit from: the possibility of making investments in any field and in any legal forms provided by the law; equality of treatment - fair and equitable - for Romanian or foreign investors, residents or non-residents in Romania; guarantees against nationalisation, expropriation, or other measures with equivalent effect; custom and fiscal facilities; assistance in undergoing administrative formalities; the right to convert in the currency of the investment sums in lei obtained after investment, as well as the right to transfer the currency in the country of origin, in conformity to the norms on custom regulation; the right of investors to choose the legal court instance or competent arbitration for settling possible litigation; the possibility to carry forward the registered losses during a financial exercise at the expense of the taxable profit of the following financial exercises; the possibility of using accelerated pay off; the possibility to deduct the costs for advertisement and publicity from the taxable profit; the possibility of employing foreign citizens, according to legal provisions in force. At the same time, investors benefit from the rights granted by the laws in force.

50. Romania has concluded a series of bilateral treaties on protection of investments with the following BSEC countries: Albania, Armenia, Bulgaria, Greece, Moldova, Russia, Turkey and Ukraine.

51. Concerning the number and investment volume of joint ventures between Romanian firms and firms from the BSEC countries:

*Azerbaijan:* 3 joint-ventures with an invested capital of 0,01 million USD.

*Bulgaria:* 236 joint ventures with an invested social capital of 7,99 million USD.

*Georgia:* 2 joint ventures with a capital of 0,01 million USD.

*Greece:* 1603 Romanian-Greek firms with a total invested capital of 85,5 million USD. This statistic does not include the Greek investment in the field of telecommunications.

*Moldova:* 760 Romanian-Moldovan firms are registered, with an invested social capital of 10,29 million USD.

*Russian Federation:* 144 joint ventures are, the value of the foreign invested capital is 3,22 million USD.

*Turkey:* A total of 5343 Romanian-Turkish firms were registered, with a total invested capital of 176,9 million USD.

*Ukraine:* 83 Romanian-Ukrainian firms were registered, with foreign invested capital of 1,125 million USD.

**Russian Federation**

52. The Russian Federation has concluded bilateral agreements on the promotion and mutual protection of investments with the following BSEC countries: Albania, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Turkey and Ukraine.

**Turkey**

53. Turkey has signed agreements on promotion and protection of investments with the following BSEC countries: Albania, Azerbaijan, Bulgaria, Georgia, Moldova, Romania, Russia and Ukraine.

54. The basic principles of the Turkish foreign capital policy are as follows:

- Foreign investors have the same rights and responsibilities as Turkish ones;

- There is no limit to foreign partners' shares;
- There is no need for approval by the Council of Ministers of applications for foreign capital in the amount up to 150 million US dollars;
- Transfer of profit shares, royalties, closing-down of companies, etc. can be done free of charge.
- A company with foreign capital is allowed to hire foreign personnel for managing or technical purposes.
- Foreign capital can be deposited into the currency accounts without changing into Turkish Lira.
- As there is no need any more for approval of agreements on licences, know-how and technical support, they must be registered at the General Administration on Foreign Capital.

55. In 1980 the actual amount of the foreign capital investments on the basis of 97 permissions was equal to 35 million USD, in 1989 there were 1,511 permissions for 855 million dollars, starting with 1990 this figure turned to be approximately 1 billion dollars. By the end of 1998 the total amount of the foreign capital inflow into the country was 11 billion dollars.

56. What could the BSEC countries do in order to promote investments? Stability of political and economic situation in the BSEC participating states is the basic condition for promotion of foreign investments. Instability in the region is the main reason for low rate inflow of foreign capital investments there. The following needs to be done in order to promote investments into the region:

- To modernise the legal framework on economic activities, icnluding liberalisation of foreign capital legislation;
- To speed up the privatisation process;
- To bring inflation and interests' rates to a reasonable level;
- To control competition by economic methods;
- To give more importance to production-management-transportation and production-management modalities and to make the necessary changes in the respective legislation;
- To take more serious efforts at investment promotion activities on the international level.

## E. GENERAL RECOMMENDATIONS

57. The BSEC countries have already expressed their belief in the merits of international rules for investment as a vehicle for encouraging investment flows beneficial to economic growth, sustainable development and job creation, and as a contribution to a rules-based system for managing globalisation. There is already a great deal of work undertaken in the conclusion of the existing bilateral agreements for promotion of investments and avoidance of double taxation in an effort to establish a comprehensive legal framework for the treatment of foreign investment in the Black Sea region.

58. The will is certainly there; there is a general recognition of the need to complete work on protection of investments, containing disciplines achieving a high standard of liberalisation and a satisfactory balance of commitments, which takes full account of economic concerns and political, social and cultural sensitivities of the member states.

The general principles of investment cooperation in the BSEC region, as adopted on 25 October 1996 in Moscow by the BSEC Ministers of Foreign Affairs are the following:

- **non-discrimination,** by granting to foreign investors a regime that will not be less favourable than that enjoyed by indigenous investors in a similar situation concerning all aspects of the establishment and post-establishment treatment of foreign investment; to ensure that no special restriction will be introduced with regard to establishment of foreign investments except the cases treated by the national foreign investment legislation;

- **transparency**, by encouraging exchange of information among themselves on their national legislation pertinent to investment into their economies;
- **investment control,** by considering steps conducive to a better foreign investment environment in order to minimise the requirements that control investments;
- **investment stimulation,** by consulting each other before relaxing their requirements with respect to health services and environment protection for purpose of attracting foreign investments;
- **expropriation and compensation,** by avoiding expropriation of foreign investments or take any similar measures, except for public purposes and on the basis of non-discrimination, in compliance with the legislation in each particular country and principles of international law, and on condition that sufficient and effective compensation be paid in good time;
- **convertibility,** by taking every measure guaranteeing free convertibility and transfer of money proceeding from foreign investments, vis-à-vis earned profits, dividends, fees, royalties, emoluments, payments for loans, liquidity funds, ensuring that this operation is exercised within reasonable time.
- **entry and sojourn of key members,** by ensuring that key personnel will be able to enter and remain in the respective country in order to engage in activities connected with the development, management, maintenance, use, enjoyment or disposal of relevant investments, including the provision of advice or key technical services;
- **elimination of restrictions for exporting capital**, by agreeing to work towards eliminating all restrictions for export of investments and profits earned thereby;
- **investor's conduct,** by ensuring that a foreign investor will like indigenous competitors observe laws, administrative rules and procedures of the recipient country;
- **settlement of disputes,** by agreeing that disputes connected with foreign investments (both investor-to-state and state-to-state) could be resolved in short time by way of consultations and negotiations between the sides involved or, if they will fail to come to terms, through procedures as envisaged by international obligations and commitments of the BSEC Participating States or via any other means acceptable to the parties involved;

59. There is a number of additional points that have to be taken into account in the creation of the legal framework in investments: compatibility with international agreements, including the WTO, and the IMF is one of the priorities. Extensive dialogue with representatives of business, labour, and other non-governmental organisations is also an important part of the process.

60. Provisions concerning the entry, stay and work of investors and key personnel, the participation of foreign investors in privatisation activities, investment incentives, a prohibition against certain performance requirements imposed on investors, and a prohibition of nationality requirements for senior management positions are usually indispensable parts of investment protection legislation.

61. Additionally provisions related to financial services, including banking, securities and insurance activities have to be drafted, including access to information transfer and data processing. The same applies to temporary safeguard provisions in the event of serious balance of payments and external financial difficulties or where capital movements cause serious difficulties for monetary or exchange rate policies.

62. Another consideration is environmental protection and labour issues, and the broad support for including a strong commitment by governments not to lower environmental or labour standards in order to attract or retain an investment.

63. The BSEC countries could in the long term examine the possibility to adopt a multilateral agreement on promotion and protection of investments. In the meantime a first necessary step would be the conclusion of bilateral treaties covering all the countries in the region, resulting to a web of agreements including all eleven Member States.

64. Adherence to the WTO agreements and perhaps the forthcoming multilateral agreement on investments of the OECD could lead to a multilateral framework containing transparent and clear rules preventing discrimination and obstruction of FDI, assuring competitive behaviour and regulating measures which distort the market.

65. A regional regime, negotiated by all the countries set to gain from it, would go a long way to ensuring that the most needy countries were not by-passed by flows of capital, technology, and the skills and training which investment makes available. At the same time, it could provide the necessary assurances, to both host and home countries of investors, that increased investment flows would not jeopardise the pursuit of legitimate domestic policies, such as social, environmental or developmental policies.