UNITED NATIONS

ECONOMIC AND SOCIAL COUNCIL

GENERAL

E/C.2/287
27 February 1951

ENGLISH
ORIGINAL: ENGLISH/FRENCH

COUNCIL COMMITTEE ON
NON-GOVERNMENTAL ORGANIZATIONS

Twelfth session
Item 6

FINANCING OF ECONOMIC DEVELOPMENT OF UNDER-DEVELOPED COUNTRIES

Statement submitted by the International Chamber of Commerce, a non-governmental organization granted consultative status in category A

The Secretary-General has received the following statement, which is circulated in full with the approval of the Council Committee on Non-Governmental Organizations in accordance with paragraph 23(d) of Council resolution 288 B (X):

Dated: 7, 9-10 January 1951
Received: 18 February 1951

GOVERNMENTAL GUARANTIES TO INVESTORS

Statement

adopted by the Council of the International Chamber of Commerce at

its 74th session, 9-10 January 1951

Since the publication of its June 1950 statement and report on "Financing Economic Development" (Brochure I42), the International Chamber of Commerce has made a careful study of the question of governmental guaranties to investors in the capital exporting countries. After considering the arguments for and against, the ICC believes that there are circumstances in which such guaranties may undoubtedly serve a useful purpose. It is for each country to decide this in the light of prevailing conditions and of the economic policy it is pursuing. In any

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case, the system of governmental guaranties to private investments is more or less in the nature of an experiment and should be treated as such. Its continued application should depend upon the results achieved in the earlier stages.

There are two questions of principle, however, which must be emphasized at the outset.

First, guaranties should be given to the investors by the capital exporting countries only in the case of investments in countries which treat foreign investments fairly, along the general lines of the ICC's Code (Brochure I29). To do otherwise would be to place a premium on unfair practice and to relieve the investee country of its responsibilities at the expense of the tax payer in the investor country.

Secondly, the granting of guaranties should not involve supervision and control of the investment by the guaranteeing government. Legislation should be so drafted as to ensure this, and investors should refrain from making use of the guaranties if they carry with them governmental control over the investment.

Where governments of investor countries decide to introduce guaranties covering investments made abroad by their nationals, the following rules should be observed:

1. The types of risk to be covered are mainly the risks of transfer arising out of the prevailing non-convertibility of currencies and the risks of expropriation. No attempt should be made to cover the usual business risks an investor must inevitably face when venturing his capital abroad, and in the case of war risks special arrangements may be necessary.

2. Guaranties should be extended to new investments only, including additional investments in existing enterprises. Old investments were made without any expectation of a guaranty. There should, however, be no discrimination between

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new and already existing investments in the policies of capital importing countries.

3. Guaranties should be made available only against the payment of an appropriate premium.

4. The government agencies entrusted with the administration of investment guaranties should be empowered to charge different rates of premium according to the area or country in which the investment is made. If the purpose of the guaranteeing government is to develop resources important for defense, it might also be advisable to differentiate as between industries. Such differentiation in the rates of premium should not be considered as discriminatory or as an undue interference with private enterprise.

5. In order to be effective, any guaranty that is extended should cover both the principal of a foreign investment and the current income earned by it.

The ICC submits these recommendations, which are explained in detail in the attached report of its Commission on Foreign Investments and Economic Development, to the earnest attention of individual governments as well as of the Economic and Social Council of the United Nations and other interested inter-governmental organizations.

GOVERNMENTAL GUARANTIES TO INVESTORS IN CAPITAL EXPORTING COUNTRIES

Report

adopted by the Commission on Foreign Investments and Economic Development of the International Chamber of Commerce,

7 January 1951

INTRODUCTION

1. In its previous reports the Commission on Foreign Investments and Economic Development concerned itself (a) with the importance and scope of private foreign investments and the difficulties which, following the end of World War II, stood in the way of their revival*; (b) with measures to be taken by capital importing countries in order to create a political, social and economic "climate" favourable to the influx of private foreign capital, these requirements being summed up in the ICC's "Code of Fair Treatment for Foreign Investments" **; (c) with problems relating to the financing of economic development, particular reference being paid to the importance of currency convertibility for the revival of international capital movements***.

2. Taking its inquiry a step further, the Commission on Foreign Investments and Economic Development now turns its attention to measures which capital exporting countries might adopt to stimulate the outward movement of private capital towards foreign countries.

3. Since the spotlight is thus thrown on a part of the picture with which the International Chamber of Commerce has not so far concerned itself, it may be useful first to restate the assumptions underlying the ICC's approach to the problems of foreign investments:

(a) An abundant flow of capital between countries is an important feature of a well-functioning world economy; it allows a better utilization of the world's resources, helps the maintenance of a balanced growth of multilateral trade and favours a gradual improvement in living standards everywhere and in the less developed areas of the world in particular. That is why the ICC, which favours expansion of multilateral world trade and higher living standards throughout the world, has given so much attention to the problem of reviving the international flow of capital.

(b) Since the ICC believes that private enterprise provides the economic life of nations with a dynamic quality of the highest efficiency, it favours

* ICC Brochure No. 107.
** ICC Brochure No. 129.
*** ICC Brochure No. 142.

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the utmost expansion of private foreign investments. It recognizes, however, that there are certain types of investment which do not fully lend themselves to the operations of private enterprise: the building of roads, harbours, the development of health services and so forth are examples of investments which are proper outlets for publicly-controlled capital. Such basic publicly-financed investments can greatly expand the opportunities which exist in the particular area for private business investments.

Looking upon this question in a broad perspective, private and public investments appear as partners rather than as antagonists. It is only when arbitrary measures keep private capital out of fields of activity for which it is suited or when unreasonable hostility is shown to public funds venturing into an area where they can render uniquely valuable services, that conflicts appear which are more apparent than real and always very costly to the public at large.

(c) Among various types of private foreign investments, that which in our day offer the most promise for prosperous expansion consists of what is called direct business investment. This carries into the investee country technical know-how and managerial skill along with financial resources and thus embodies some of the features of a "Point IV Program". Such investments seem to be more attractive to the investors than portfolio investments and may offer far greater advantages to the capital importing country.

(d) The expansion of private foreign investments in general and direct investments in particular depends primarily upon the political, social and economic climate in the capital importing country. International insecurity aside, the actions of the government of the capital importing country and the attitude taken by its public can do more than any other single factor to promote the influx of private foreign capital.

The ICC at the same time fully recognizes* that the foreign investors must conduct their business with an eye not only to their own profits but also to the welfare of the country in which they operate.

(e) While realizing the importance of economic development in the less developed areas of the world, the ICC has always felt that capital movements between countries in the "developed" group are very important for the prosperity of the world and for the future of international commerce. Indeed, the ICC has never been greatly impressed with any hard and fast division of the world into developed and underdeveloped sectors. There is scope for economic growth and development in every single country of the world and, therefore, scope for the investment of capital both domestic and foreign.

It should also be borne in mind - and the ICC has emphasized this point in a previous publication - that foreign investments need not be merely one-way movements of capital, but that there can be scope for reciprocal investments

* ICC Brochure No. 142, VI. Social Responsibilities of the Investor.

/by businessmen

by businessmen of two countries in one another's territories. Relations between the United States and the United Kingdom, for instance, illustrate why capital movements should be regarded as two-way phenomena.

4. Having thus stated the assumptions underlying the ICC's attitude towards foreign investments, let us turn our attention to the subject immediately to hand, - that of guaranties which governments of capital exporting countries might extend to their own investors who would venture abroad.

I. SHOULD CAPITAL EXPORT BE ENCOURAGED BY THE GOVERNMENT OF THE EXPORTING COUNTRY - AND WHY?

5. The problem of governmental guaranties by capital exporting countries has attracted in recent years a considerable amount of attention. This is a new departure since previously it was generally considered that private investment should be guided by conditions in the capital importing countries and by the attitudes of individual investors but should not be promoted or pressed in any way by the governments of countries which have the available resources to export capital. Why that shift of emphasis?

6. The new emphasis on the importance of exporting capital finds expression in two ways which are characteristic of two different attitudes with regard to private as against public foreign investment. The first of these attitudes involves the introduction of governmental guaranties or insurance schemes for private investments and other incentives which a government might give to its investors to induce them to go abroad with their funds. The other attitude consists in substituting governmental capital exports for private ones, thereby expanding the total of capital exports while curtailing (directly or indirectly, by design or inadvertently) the scope of private transactions in that field.

7. The positive attitude of governments towards the export of capital from their territory (as distinct from the neutral attitude in that respect which was typical of older days) can be explained in terms of the following considerations:

(a) The advisability of developing foreign supplies of materials of strategic importance.

(b) The desirability of substituting, wherever possible, private investments for governmental or intergovernmental grants, thereby alleviating the burden on the taxpayer.

(c) The achievement of a better balance in the country's foreign payments, thereby obviating the adoption by foreign countries of trade and payments restrictions such as exchange controls, quotas and other discriminatory practices.

(d) The desire to help the less developed areas of the world to acquire a higher rate of growth and development, thereby affording better living standards for their peoples, reducing the risk of social unrest and political strife, and also enlarging the markets for the products of other countries including the capital-exporting countries themselves.

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8. These reasons, which are behind the current interest in actively promoting, by government policy, the export of capital, are of varying importance and varying degrees of justification. Of these reasons the first two must probably be regarded as the most important at the present time and likely to remain important for years to come. The third applies to short or medium run situations rather than to long run conditions of international economic relations; capital exports cannot be regarded as a permanent or semi-permanent substitute for such domestic policies as ultimately result in achieving and maintaining equilibrium in the foreign accounts of the various countries. The fourth reason for promoting capital exports involves both political and economic considerations of great importance for the world as a whole, some of which are of a controversial nature.

II. GOVERNMENT GUARANTIES BY CAPITAL EXPORTING COUNTRIES

9. In the opinion of the Commission on Foreign Investments and Economic Development, governments of capital exporting countries may find it well worth their while to consider ways and means by which they could encourage foreign investments. The Commission's recommendation is conditional upon the following considerations:

(a) The incentives, whatever they are, should apply only to capital exports to countries which are doing their best to secure a favourable climate for private foreign investments along the general lines of the ICC's Code of Fair Treatment for Foreign Investments.

(b) The policy should be regarded as experimental and its continuation should depend upon the results obtained in the early years of its operation.

(c) There should be no discrimination in the capital importing countries between investments made while the experiment is in operation and those which were made previously.

10. The risks faced by a foreign investor can roughly be divided into four groups:

(a) The usual business risks which are greater in a country which the investor does not know very well and in which the legal set-up, the way of life, the habits of the people and the operations of government may be at considerable variance with those to which he is accustomed at home.

(b) The risks resulting from inconvertibility of currency with the consequence that the investor may be unable to use freely all or part of his profits or realize wholly or partly his investment.

(c) Risks resulting from political actions of the foreign governments such as nationalization or expropriation.

(d) The risks of war.

11. Of these four main kinds of risk, the first is not a proper object for government guaranties, since business risks are inherent in the operation of private enterprise.

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12. The second and third types of risk are those which lend themselves particularly to any scheme of guaranties that might be designed; they will be discussed in greater detail below.

13. As regards the risks of war, those are clearly of a different order of magnitude and may require special treatment.

14. We are, then, left with the risks of inconvertibility and the risks of expropriation. Any guaranties extended against these two kinds of risks must presume a cooperative attitude on the part of the governments of investee countries. Only if the latter governments undertake to act in accordance with the standards of fair play set out in the ICC's Code and only if they are determined to work towards an eventual restoration of the convertibility of their national currency, can the government of the capital exporting country assume the financial charges which a guaranty scheme involves or may involve over a period of time.

15. If guaranties are looked upon in this light, i.e., as a part of a cooperative arrangement between the governments of the capital exporting and those of the capital importing countries, a reasonable case can be made for their adoption. Indeed, under the described circumstances they may be very helpful for the restoration of conditions under which private capital movements could take place without any further use of the expedient of guaranties. It might be observed, for instance, that from the point of view of a capital importing country, the provision of a comparatively small amount of foreign exchange for the purpose of providing for freedom of transfer of profits, capital repayments, etc., would be more than compensated by the benefits it would derive from an inflow of foreign capital. Such an inflow would appreciably diminish internal inflationary pressure and lead to an increase in the country's international trade without necessitating a reduction in either current consumption or capital formation for the purpose of reconstruction and development. On the other hand, an influx of capital from abroad might improve an importing country's balance of payments and thereby help it to adopt the more liberal administration of foreign exchange reserves.

16. Transfer risks are those where guaranties by governments of capital exporting countries might do the maximum amount of good, always on condition of a cooperative attitude on the part of the governments of the investee countries. As far as current dividends, fees and royalties are concerned, the problem is manageable in size. It becomes more complicated when a capital importing country adopts a nationalization program which involves the expropriation with or without compensation of certain assets held by foreign investors. If the government of such a country lives up to the principles of the ICC's Code, a guaranty scheme applied by the capital exporting country can be very helpful indeed.

17. Transfer risks disappear, of course, completely, once international payments have been freed from restrictive controls and so long as currencies remain fully convertible. The ICC has already strongly drawn attention to the importance of convertibility from the point of view of expanding foreign investments in its report on Financing Economic Development.*

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* ICC Brochure 142, July 1950.

III. PRACTICAL CONSIDERATIONS ON THE APPLICATION OF GUARANTY SCHEMES

18. If guaranty schemes are applied by governments of capital exporting countries, there arise a number of practical considerations requiring careful attention:

(a) Should the guaranties be limited in amount or unlimited?

(b) Should the beneficiary of the guaranty pay a premium to his government to pay for the benefits given by the guaranty?

(c) Should guaranties apply only to new investments or should foreign investments already in existence be eligible for a guaranty upon the payment of a premium?

(d) In case the system of premium payments is adopted and in case existing investments are eligible for guaranty, should there be a uniform rate of premiums for old and new investments or should there be a differential in favour of new investments?

(e) Should the governmental agency administering the guaranty scheme have discretionary powers about investments to which guaranties should be given and those to which they should be refused, or should all applicants for a guaranty be equally eligible?

19. In answering these questions the Commission on Foreign Investments wishes to recommend the following principles which should underlie any schme of government guaranties of foreign investments:

(a) Guaranties should only be available against the payment of an appropriate premium (this is sometimes called "insurance" of foreign investments although the terminology is not appropriate considering the complete absence of an actuarial basis on which to establish the size of the premiums).

(b) Although existing investors might consider themselves to be placed at a disadvantage, it is nevertheless the opinion of the ICC that guaranties should be extended only to new investments - this to include any additional investment in an existing enterprise. Existing investors were content to make their investment without expecting any guaranty, whereas the present purpose is to encourage a new flow of investment which might otherwise not take place. Attention should also be directed to the size of the contingent liability that might be incurred by the government of a country through the extension of guaranties to existing foreign investments and to the burdens which might ensue at a later date for the taxpayers of that country. However, existing investments should not be subject to discriminatory treatment in capital importing countries, because of the difference of position in the matter of guaranties.

(c) It would be inappropriate to offer uniform terms in respect of investment in any part of the world. If the purpose of the guaranteeing government is to develop resources important for defence, it might also be advisable to differentiate as between industries. The government agencies entrusted with

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the administration of investment guarantees would therefore have to be permitted latitude in fixing premiums at differential rates. The fixing of a higher premium in some cases than in others could not then be considered discriminatory or an undue interference with private enterprise. If governments are to incur the obligations involved in the offer of guarantees, the investment so stimulated must obviously subserve national interests; what is important is that the private enterprise should become as far as possible the instrument by which such investment is carried out.

(d) In order to be effective, any guaranty that is extended should cover both the principal of a foreign investment and the current income earned by it. As the experience of ECA guaranties clearly shows, a limitation of guaranties so they cover less than the above, tends to destroy their effectiveness as a stimulant to new foreign investments.

IV. PITFALLS TO AVOID

20. There are two major pitfalls to which attention needs to be directed lest the adoption of government guaranties destroy the effectiveness of the domestic and international free enterprise economy.

21. In the first place, the existence of guaranties by governments of capital exporting countries might diminish the eagerness on the part of governments of capital importing countries to create political, social and economic conditions (a "climate") attractive to foreign capital. The existence of guaranties must not in any way conceal the fact that the primary responsibility for inducing international capital movements rests with the governments of capital importing countries. This pitfall will be largely avoided if the ICC recommendation, that guaranties should only be made available to investments in countries whose governments accept the principles of the Code of Fair Treatment for Foreign Investments is acted upon.

22. In the second place, there is the possibility that government guaranties of foreign investments might lead to the supervision and control of the investment by the guaranteeing government, thereby expanding the scope of governmental control over private enterprise. This can only be avoided by the proper drafting of legislation and by the refusal of business itself to apply for guaranties should these be coupled with unacceptable controls. Here, as in so many other matters, the price of freedom is vigilance.

V. TAX INCENTIVES TO PRIVATE FOREIGN INVESTMENTS

23. While this report is essentially directed to the question of government guaranties, it would remain incomplete without at least a brief reference to the possibility of stimulating private foreign investments by means other than guaranties - namely, through appropriate taxation policies. The following is no more than a brief enumeration of possible tax incentives, each of which deserves careful and detailed further study:

(a) Full relief from double taxation, both through unilateral action and by bilateral treaty;

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(b) Further special tax relief in favour of earnings from foreign investment, such as the treatment of earnings as repatriation of principal until the principal amount has been recovered.

(c) Exemption from taxation in the capital exporting country of non-repatriated earnings.

Attention must, of course, be directed to the tax incentives which it is only in the power of the capital importing country to administer and which may prove far more attractive to foreign investors than anything that can be offered in that respect by their own government.