PROTECTION OF INVESTMENTS AND RESOURCE NATIONALISM

London

Brussels

Hong Kong

Beijing

SLAUGHTER AND MAY

WHY WORRY?

Why worry about resource based investments into Africa?

- The risk inherent in an investment depends upon the stability of the surrounding investment environment
- There can be a significant under-appreciation of the risk
- The origins of the risks are complicated

Why is this risk increasingly relevant now?

- The established systems are being challenged: Brexit; anti-capitalism; shifts in economic and political balances
- Dwindling resources drive resource nationalism and government activism; competition for scarce resources has greatly intensified

RESOURCE CURSE / PARADOX OF PLENTY

Why are resource rich countries risky?

Having significant natural resources has been referred to as “resource curse” or the “paradox of plenty”:

- Having significant resources can do a country more harm than good
- Countries with natural resources are susceptible to stunted economic growth, poverty, authoritarian rule, corruption, and conflict (internal and external)
- The bigger the level of resources, the bigger the scramble to take a share

The paradox: resource rich countries are poor (economically, and otherwise)

The result: investing in a country with significant natural resources is risky business

THE EVIDENCE

What is the evidence?

- Many Arab countries have lower GDP per capita now than they did 30 years ago.
  - Example: Saudi Arabia was 5th in the world in income in 1980, and is now ranked 40th (according to IMF)
- Resource rich countries tend to do worse on the UN's Human Development Index
- Resource rich countries tend to have higher child mortality, lower literacy, fewer educational and health opportunities and figure more prominently on bribery and corruption lists
- Resource rich countries are more likely to be ruled by unelected, authoritarian and unaccountable regimes
- Resource rich countries are much more likely to be engaged in conflict: by a factor of 4 in Africa

THE CONSEQUENCES

What are the consequences?

- Unelected and/or corrupt governments become entrenched
- There is no need for legal systems to develop which promote, protect and support investments
- Foreign direct investment is limited to the resource sector, and that invested capital (often unknowingly) becomes hostage to the corruption, politics and systemic problems within the country
- Reduced job opportunities: population growth outstrips economic growth rates

THE CAUSES

What are the causes?

- Foreign demand for natural resources leads to an influx of foreign cash which results in a sharp appreciation of the local currency
- Other exports become uncompetitive, and therefore output in other industries declines
- The resource sector is generally capital intensive and employs fewer unskilled workers
- Countries have no incentive to invest because they can simply buy whatever they need: this leads to underinvestment in the future, which simply creates further resource dependency
- Resource price fluctuations lead to price shocks which affect those who cannot protect themselves
- Wealth becomes concentrated in the resource sector: i.e. in the government and those that provide services in relation to the resources
- Those in control of the resources can fund their continued dominance in government and in the economy

A PARADOX IS A PARADOX

- The underlying question is what comes first? The resource or the problem?
- Traditional theory:
  - Countries (i.e. their governments, leaders and politicians), suddenly awash with wealth, fail to invest as needed and can afford to repress the population, engage in conflicts etc.
- Alternative theory:
  - Countries with bad politics, corruption and conflict (already in existence) create the dependence on resource wealth
  - Examples: countries which have substantial natural resources but who have not become subject to the resource curse e.g. Norway; Australia
- In the end, the theory does not matter.
- The key point is that the prevalence of natural resources is usually coupled with a substantial increase in investment risk.

THE RISKS

What are the risks of investing in resource rich countries?

Legal risks:

- Restrictions on owning assets, remitting profits, etc
- Resource permits: can they be easily obtained, can they be revoked, what terms and conditions might be imposed?
- Enforcement of contracts: will local courts enforce foreign judgments, how will they interpret and apply the contract?
- Judiciary: is the judiciary independent, how will it treat the government?

Political risks:

- Expropriation or political “interference”: freezing, discrimination, taxes, resource nationalism
- War, internal riots
- Local issues: pressure groups, community organisations, NGOs

RESOURCE NATIONALISM

The hostage problem:

- a State has a sovereign right to manage affairs in its own jurisdiction and can, in theory, do so with impunity;
- once capital is committed, an investor is hostage and fully reliant on investment protection

GOVERNMENT ACTIVISM – EXAMPLES

- Seeking breaches of existing contract terms
  - Example: used by Sonangol against Shell in its sale of Angolan Block 18 to OVL
- Exploiting gaps in the chain of title
  - Example: used by Nigeria to prevent pre-emption by ENI of Shell's sale of oil mining licences to Oando
- Challenging the validity of original licence award
  - Example: used by Libya to intervene in sale of Verenex
- Refusing to grant consent to a transaction:
  - Example: used by Ghana against Kosmos to prevent sale to Exxon

VALUE EXTRACTION – EXAMPLES

Governments are increasingly seeking to extract value from specific transactions through the following means:

- Pre-empt sales: usually designed to disrupt a sale to extract payments or lower price
- Impose new taxes or transfer fees
- Revoke licences (or threaten to do so)
- Assert breaches associated with sales process (especially relating to release of data)

Governments also seek general profit extraction through:

- Regulatory breaches and fines
- Competition rulings
- “Resourceful” interpretation of contractual obligations

PROTECTING INVESTMENTS

Investment protections take a variety of forms, including:

- treaties: bilateral and multilateral
- laws and decrees
- licences, concessions, implementation agreements
- binding undertakings
- non-binding assurances and comfort letters
- political risk insurance
- use of dispute resolution (arbitration vs. courts)
- transparency: the strategy being to disclose everything so that it cannot be attacked later e.g. contractual terms, bonuses, commissions, involved parties
- understanding a country’s obligations to World Bank, the Extractive Industries Transparency Initiative, etc: ensures much greater public scrutiny of behaviour
- forensic and strict adherence to contract terms

QUESTIONS