

# Fair Contracts for Poor Countries

by [Karl P. Sauvant](#)

A number of countries in Latin America, Africa, Eastern Europe, and elsewhere are abrogating or renegotiating contracts with multinational enterprises (MNEs), and others are likely to follow suit. The costs can be high. Governments may get better terms, but they may also become embroiled in international investment disputes and discourage other investors. For companies, renegotiations mean uncertainty and possible interruptions of production and revenue.

Significant shifts in power (typically as a result of changes in commodity prices) and ideology, or changes in the economics of projects, can lead to renegotiations, especially when it comes to large investments in natural resources and infrastructure. But often the reason is that the host country considers a contract to be unfair.

While “fairness” may well be in the eyes of the beholder, in some cases, the host country may not have had the expertise required to negotiate the best possible deal – a frequent situation when MNEs negotiate with the least developed countries (the world’s 50 poorest countries, most of them in sub-Saharan Africa). Mittal’s 2005 deal with Liberia (renegotiated last year) and various contracts with Congo probably fall at least partly into this category, as do some deals in ex-Soviet countries.

Suppose a \$500 million petroleum or copper contract needs to be negotiated. This will most likely involve a leading MNE, which can field a negotiating team that includes world-class lawyers, geologists, and financial analysts who understand, for example, the trade-offs between taxes and royalties and can put them in appropriate language. The host country, on the other hand, simply cannot match such a team. Perhaps it does not even know what to ask for.

The resulting contract is all the more problematic because it is likely to involve one of the host country’s few important resources, which can generate more predictable (and probably higher) revenues than official development assistance – and over a long period of time. So, even without corruption, it is not surprising when a future government demands that the contract be renegotiated.

Clearly, the playing field with MNEs should be leveled. In theory, the host country could hire its own international experts to assist it in negotiations. But poor countries typically lack the funds needed to pay such a team’s fees. Nor do the World Bank and regional development banks have the in-house expertise – or, as a rule, the funds – to provide technical assistance.

But what if MNEs provided the funds? Obviously, MNEs want the best possible deal for themselves; but they also want durable contracts that won’t be repudiated by the next government. So they have an interest in negotiating a fair deal, and one that is *seen* to be

fair. Besides, in large deals, the negotiating team's costs are relatively small (or they could be reimbursed out of the project's revenue stream).

But, even if a company embraces this approach, problems abound. How can it be implemented without looking like bribery (in case the company gives the funds directly to the government)? And how can companies prevent some of the funds from being misused (say, if the government hires a third-rate team)?

Here is a proposal: an Investment Contract Aid Facility (ICAF) under the umbrella of a well-respected organization. The ICAF would function like an escrow account into which the firm pays the funds required for the host country to hire a negotiating team. The escrow account manager then invites the country to select a team, suggesting what skills are required and perhaps even providing a roster of experts.

The country would be free to choose its own team, but the escrow account manager, aided by an international advisory board of expert volunteers, would need to agree that it is, in fact, world-class. One could even include a capacity-building element by adding to the team one or two local negotiators. The result should be a contract that is as fair as possible under the given circumstances – and perceived as such.

It would be enough for a handful of CEOs and prime ministers to say that they are prepared to consider using such a Facility on a case-by case basis. While this would not end the abrogation or renegotiation of contracts, it would eliminate one important reason for them, benefiting countries and companies alike.

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