



Foreign Direct Investment in Mining: An Opportunity and Challenge

Within the context of the 2030 Agenda and the Sustainable Development Goals, foreign direct investment (FDI) is crucial for sustainable development, especially in developing countries and economies in transition. FDI can bring a wide range of benefits for countries beyond simple revenue generation. Other benefits include the creation of employment and the transfer of technology, as well as the creation of local businesses that feed into the supply chain of the investor.

Investment into the natural resource sector has the potential to drive economic growth and development for many developing countries and economies in transition. For many countries, the mining sector often serves as the most viable means of generating revenue for the national budget, along with the potential to drive economic growth and development. The importance of the mining sector to these countries calls for a concerted effort to ensure that mining projects deliver on the promised benefits of FDI in addition to unlocking the revenue potentials needed to achieve the Sustainable Development Goals.

To ensure this happens, it all starts with the contracting process. It is during the contracting process that the terms of the complex relationship between host governments and mining companies are negotiated and agreed upon.

▀▀ UNCTAD estimates that current Goals-related investments in developing countries by the public and private sector combined are in the order of \$1.4 trillion, and total annual investment needs to accomplish the Goals by 2030 are around \$3.9 trillion. This leaves an annual gap of \$2.5 trillion. ▀▀

▀▀ Foreign direct investment is the largest source of external finance for developing countries. It is also a significant source of finance in the least developed countries, along with official development assistance and remittances. Potential benefits of foreign direct investment include the creation of higher skilled jobs, the introduction of technology and innovation and improved access to international markets. ▀▀

UNCTAD: Promoting Investment in the Sustainable Development Goals, 2018.



The negotiation of large-scale, complex investment contracts is a delicate endeavor. The host government is seeking to maximize revenue from mineral projects and balance the expected positive economic benefits for its citizens with potential adverse social and environmental effects. The investor wants to maximize its share of the revenue from the project while also seeking to mitigate risk and protect its investment. A balance between the interests of both parties has to be reached and documented. This is accomplished through the contract, which codifies the complex relationship between the investor and host government regarding revenue sharing as well as any rights and obligations.

Therefore, it is very important that this process is handled with utmost care, with both parties approaching the negotiation table well-prepared and with the required expertise.

ASYMMETRY AT THE NEGOTIATING TABLE LEADS TO BAD DEALS

Mining companies are skilled at negotiating contracts and are well equipped with internal and external advisory support. This contrasts sharply with many governments of developing countries and economies in transition. They often do not have the experience nor the human or financial resources to prepare effectively for negotiating mining contracts. The unfortunate result is that they agree to terms that are not favorable to the country, leading to the loss of economic benefits, often with disastrous social and environmental impacts.

The negative outcomes of poorly negotiated contracts extend to investors as well: Lopsided deals are unstable deals. They are deals that invite anger and disaffection from citizens and local communities. Disaffection leads to conflicts and confrontations, which in turn lead to abandoned mines, project disruption, and revenue losses to the investor.

Given the obvious asymmetry in negotiation capacities and the potential negative outcomes from bad deals that impact all stakeholders, it is clear that there are significant benefits to

ensuring that governments are able to negotiate with mining companies on an equal footing, and with access to the same level of information, expertise, and advisory services that companies bring to the negotiating table.

ADDRESSING THE ASYMMETRY THROUGH SUPPORT FOR GOVERNMENTS

CONNEX was established to strengthen assistance for complex contract negotiations. At their Brussels Summit in June 2014, the G7 Leaders announced a new initiative “to provide developing countries with extended and concrete expertise for negotiation complex commercial contracts,” focusing initially on the extractive sector. The steps leading to this milestone included years of dialogue, dedicated work, and coordination among various stakeholders. (For additional information about CONNEX’s history, visit the CONNEX website.)

In January of 2017, the German Federal Ministry for Economic Cooperation and Development provided the seed funding to launch the CONNEX Support Unit—to serve as the implementation structure of the G7 CONNEX Initiative. The CONNEX Support Unit consists of a Governing Board, an Advisory Committee and a Secretariat. Its main mandate is to provide multi-disciplinary assistance to developing countries and economies in transition—anywhere in the world—in negotiating large-scale, complex investment contracts. The assistance provided by the CONNEX Support Unit is guided by the interests of the governments that request support.

HOW TO REQUEST SUPPORT

Representatives of governments of developing countries or economies in transition that are facing an ongoing or upcoming negotiation can send an email to support@connex-unit.org to request support. Any points of clarification or questions regarding eligibility can also be addressed to the same email address.

HOW CONNEX SUPPORTS

The CONNEX Support Unit provides demand-driven and targeted but comprehensive assistance in negotiating or renegotiating large-scale contracts in the extractive sector.

- » The range of expertise needed to negotiate mining contracts is diverse. CONNEX provides teams of multi-disciplinary experts to support governments in contract negotiations.
- » As the scope of support required may not be clear at the beginning, CONNEX support is flexible and responsive to the changing negotiation context. Governments do not need to know the full scope of the required support when they request assistance from CONNEX.
- » Since each project is very different, support is tailored-made to each particular negotiation context.

CONNEX support typically takes two forms: pre-negotiation support and direct negotiation support.

PRE-NEGOTIATION SUPPORT

Whether a mining company has approached the host government or the government is initiating the process itself, CONNEX can provide support to the pre-negotiation process. The pre-negotiation stage is just as important as the actual negotiation. This is when the host government gathers as much information as possible about the project and identifies its negotiating position. The government wants to know the value of the resources by evaluating geological data and reviewing feasibility studies. It also wants to understand the economic importance of the project and understand the social and environmental impacts of the development of the project.

Any expertise that helps the government adequately prepare for the negotiation of the project at hand is available to requesting governments at this stage. For example, CONNEX experts can advise the government on the optimal structure of its negotiating team. An industry-specific expert can support the government in understanding global market trends in the sector, commodity pricing trends, and the current market conditions for the mineral under consideration—allowing the government to make key decisions about the investment. A social specialist and an environmental engineer can assist in reviewing the Environmental and Social Impact Assessment, in order to assess crucial information on potential adverse impacts of the project on the environment, human health, and social dimensions.

DIRECT NEGOTIATION SUPPORT

CONNEX support to host governments can continue or begin during negotiation rounds with the investor. Each negotiation context is unique, and CONNEX is agile and responsive in tailoring support delivery—in close consultation with the requesting government.



HOW CONNEX EXPERTS WORK

▀▀ The job of an advisor is not to tell a host government what it should do, but to work with government officials to find ways to accomplish what they want. That often involves coming up with alternative approaches and working through, with client officials, the advantages and disadvantages of each. The decision, of course, can only be made by officials. ▀▀

Professor Lou T. Wells, Member, CONNEX Support Unit Advisory Committee.

For example, a geologist can join the multi-disciplinary team to support the government in understanding the value of the mineral the company has discovered—and gauge how much effort will go into extracting it. A financial expert may provide invaluable insight on fiscal issues to allow the government make decisions regarding revenue streams. An environmental and social specialist can support the government in making sure that adverse effects are minimized, that environmental standards are binding, and that the projects conformity to required standards becomes part of the contractual agreement. Lawyers join these experts to draft the contracts.

These experts and more are available to requesting governments while they negotiate with mining companies.

SUPPORT TO INTERNATIONAL TENDER PROCESSES

For countries that award licenses through competitive bidding or tender processes, CONNEX is able to provide support in preparing and managing the process. Just like other licensing processes, information is key. The government needs to have enough understanding of the geology of the project it seeks to put up for tender, as well as the market conditions for the mineral. The bid documents must be well prepared and comprehensive. These documents provide the required information about the project and set out the preconditions and parameters for investment. Multi-disciplinary expertise is required to ensure that the process is well run and that the resulting agreement between the investor and the host government addresses the interests of all stakeholders.

■ ■ We appreciate how responsive CONNEX was to our request for support. The CONNEX Secretariat worked with us in defining the right expertise required for the negotiation. The independent and highly qualified experts supported us in preparing for the negotiation and during negotiation rounds. We had access to the right experts at the right time, even when the scope needed to be extended during negotiations. ■ ■

Professor Fabien Nkot, Coordinator of the Permanent Secretariat of the Strategic Council for Negotiations and Implementation of Mining Contracts, Republic of Cameroon.

CONNEX AND COOPERATION

Given that CONNEX support is ad-hoc and targeted, the CONNEX Support Unit cooperates closely with other organizations that provide assistance to governments in the governance of extractive resources. These include organizations that provide long-term capacity development to reduce the knowledge asymmetry between host governments and investors, as well as those that support the strengthening of the legal and fiscal framework and investment environment. The goal is to create synergies with existing programs, leverage respective strengths, and ensure that host countries receive robust support in the management of their natural resources.

HIGHLIGHTS AND RECENT ACHIEVEMENTS

Since beginning operations in 2017, the CONNEX Support Unit has implemented support activities in several African and Central Asian countries. These activities have encompassed both the pre-negotiation and negotiation phases. They include:

- » Provision of multi-disciplinary team of experts to support a government through negotiation rounds—including interpretation of geological data, advisory services on the optimal legal and fiscal structure for the project, and drawing up the mining convention;
- » Advisory services support to a government in identifying \$25 million of hidden revenue options;
- » Support on an international tender process—including the evaluation of geological data and the review and revision of tender specifications;
- » Several financial and legal pre-negotiation advisory services to allow the host government make key decisions on whether to grant concessions to the mining companies.

SUPPORTING SUSTAINABLE INVESTMENT WITH AN EYE TO THE FUTURE

Experience so far has provided evidence for the significance, relevance, and the value addition of CONNEX support, as well as the unique approach CONNEX takes in providing support and implementing support activities.

Given the importance of FDI to achieving the sustainable development goals, the global demand for resources, and the importance of the extractive sector for many developing countries and economies in transition, request for multi-disciplinary assistance in this context can only increase. The CONNEX Support Unit is ready and well equipped to assist countries in making mining projects support sustainable development and inclusive growth.

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