

BIAC Discussion Paper on “Freedom of Investment, National Security and Strategic Industries”

I. Support for open investment policies on the wane

1. Over four decades the OECD and its member countries have been driving forces behind open investment policies. The organisation has done more to promote the benefits of foreign investment than any other international body. Its members, who are home to the vast majority of global investors, have made binding commitments to promote international investment under the OECD Codes of Liberalisation and the Declaration on International Investment and Multinational Enterprises. Furthermore, the OECD’s Guidelines for Multinational Enterprises have positively influenced the responsible behaviour of multinationals and through this further enhanced the benefits of direct foreign investment. The Policy Framework for Investment is a significant step to promote international investment in developing and emerging economies.

2. More recently however, a number of OECD as well as non-OECD countries seem to have taken a more defensive approach towards foreign investment. The OECD business community is concerned about signals which suggest that government support for open investment policies is waning and that policy leaders appear to be turning their attention to control or even stop certain types of cross-border investments.

3. Although the OECD is the international body for promoting open policies towards international investment, the Organization has in BIAC’s view so far not been sufficiently visible in the public debate about cases of investment protectionism. BIAC believes that the Organization and in particular its leadership should become more vocal in warning against the dangers of government intervention in international trade and investment. In addition, the Organization should shed more light on members’ practices towards foreign investment and what the economic impact of these policy approaches is. Moreover, we believe that the OECD should develop guiding principles for ensuring transparency, predictability, non-discrimination and least-trade restrictiveness of investment related regulation aimed at safeguarding national security and benchmark countries’ policies in peer reviews against these principles.

II. Recent developments

4. Several OECD and non-OECD countries have taken steps to review, and in some cases tighten, regulations applied to cross-border investment and others are considering doing so. In addition to regulatory changes, policy makers have also intervened in numerous cross-border deals on a purely discretionary basis. Some of these interventions have taken the form of concrete actions to prevent a cross-border deal. In other cases government ministers, legislators or regulators made public statements to discourage foreign firms from taking over domestic ones by signalling that the potential deals were politically not welcome. The third and most drastic action against foreign investors has taken place in several non-OECD countries where governments reneged on existing agreements and tightened conditions on foreign investors or even nationalised foreign-owned assets.

5. Strengthened priority for security issues has been alleged as one of the main reasons behind the review and tightening of regulations applied to foreign investment. Moreover, while most countries continue to welcome foreign greenfield investment, mergers and acquisitions (M&As) as well as takeovers involving a “domestic” and a “foreign” firm are increasingly in the focus of policy makers and regulators for scrutiny and intervention. This is all the more the case when they take place in sectors perceived, rightly or wrongly, to be of strategic interest to the domestic economy (e.g. public utilities, natural resources, financial sector) or when they may have a potential impact on national security. Furthermore, policy makers have tried to fend off foreign investors from non-OECD countries such as China, India, and Russia, apparently partly driven by the concern that these foreign investors might not apply the same high standards of corporate conduct as domestic or OECD based companies. In several cases, policy makers also worked to discourage foreign bidders from becoming involved in takeovers in a misguided attempt to “protect” jobs and local economic interest in sectors that neither had any bearings on national security nor concerned industries (e.g. chemicals, soft-drinks, steel) that could reasonably be regarded to be of strategic national interest.

III. Various industries in many countries affected

6. The OECD paper *“Freedom of Investment, National Security and “Strategic” Industries”*¹ shows that several OECD countries have tightened regulations applied to foreign investment or are considering doing so. Emerging countries are following suit: India, for example, is particularly sensitive to FDI from Chinese companies and has deferred takeovers in the software development sector and in container terminals. Chinese officials have made warning statements about foreign investment in their economy and some Latin American countries have even expropriated foreign investors.

7. In addition, the paper includes an illustrative list of recent examples of countries imposing new conditions on investors and cases of discretionary intervention in cross-border M&As. Already this limited list covers cases that involved governments, legislators and regulators from least eleven OECD and non-OECD countries. It also includes potential investors from eight countries active in a range of diverse sectors (ports management, software development, oil, gas, electricity, banking, electrical equipment, and steel). The examples mentioned by the OECD are only the tip of the iceberg. More cases have been reported by press and nobody can really know how many more cross-border investment plans have been foiled by political intervention or were dismissed by firms already in the early planning stage because the potential investors anticipated political intervention.

IV. What’s at stake?

8. The dynamics behind globalisation continue strong. Companies have cut costs, reduced debts, restructured balance sheets and raised profits. Cash is abundant, debt can be financed cheaply and most economists are currently upbeat about the world economy, despite some downside risks. In this context, companies will persevere with restructuring, hunting economies of scale and higher international market share through investment and M&A activity.

9. Global mergers and acquisitions are now running at USD 10 billion a day and investment flows have tripled over the last 10 years. International capital stocks are now double the size of global GDP. OECD FDI statistics confirm the positive trend for cross-border investment. In 2005, FDI into OECD countries reached USD 622 billion. This is ¼ more than in 2004 and the highest level of inflows since the end of the dot com boom. Total OECD outflows rose to USD 716 billion. Although this is 8% less than in 2004, the figure represents a high FDI activity by historic standards.

¹ DAF/INV/WD(2006)5

11. Governments, through good policy, have contributed to these high levels of FDI and the even cross-border M&A transactions. FDI and M&As have become vital elements of companies' internationalization strategies and driving forces behind globalization. We believe that neither over-regulation nor protectionism are likely to stop the trend towards more international trade and investment.

12. However, regulation that limits foreign investment more than is necessary to achieve narrowly defined national security goals, as well as outright protectionism, can slow down the international investment trend and through this harm the economy. Both investment protectionism and over-regulation deprive the "protected" economy of additional capital and also of improved management practices, better business strategies, state-of-the-art-technology and increased competition that foreign investment brings with it. Moreover, investment protectionism and over-regulation of foreign investment can create spill-over effects and strengthen the anti-globalization sentiments that constantly threaten to harm global trade.

13. Even in cases where over-regulation and discretionary interventions do not prevent foreign investment, they can significantly increase uncertainties on the side of domestic and foreign companies, delay investments, make them more costly and also less efficient and through this clearly harm the economy. In a protectionist environment foreign investors need to pay more for the acquisition of an asset that a domestic investor would have to pay. Alternatively, if a domestic firm seeks to be acquired by another company, and the only interested parties are foreign, the domestic company may see the value of its assets considerably diminished.

14. It is not only the actual regulations and concrete actions against foreign investors that can create uncertainty, costs and inefficiencies, but also political signals sent out by governments, legislators and regulators. These have often had have a significant adverse impact on their national investment environment. Foreign investors who believe that they are politically not welcome may not pursue an investment no matter how economically beneficial the potential deal may be. At the same time, companies that seek an acquirer and have their headquarter in a country where the political environment for cross-border investment has deteriorated, may delete foreign investors from their bidder wish list simply because they reckon with political resistance against a cross border deal and the potential complications caused by it.

V. A role for the OECD

15. The OECD must play a lead role in promoting the benefits of foreign investment and in fighting against protectionist actions as well as overly restrictive foreign investment regulation. BIAC therefore welcomes that the organization accepted the business community's request to address the issue of investment protectionism in its work on "Freedom for investment, National Security and Strategic Sectors".

16. Governments have a duty to ensure that national security is not compromised but that argument is often easily abused for other purposes. In ports, for instance, national security interests can be served through proper governance and oversight – regardless of the nationality of whoever runs the business. As for steel, quite how a national interest can be justified to stop a cross-border merger that promises higher output in that sector is unclear.

17. Prudential regulation can be necessary to attain legitimate public policy goals. However, assuring strategic interests and safeguarding national security must not lead to politicising decisions that are best left to the market.

18. BIAC stands ready to provide business input to the OECD work on freedom for investment. The work should aim at ensuring that any regulation on foreign investment be applied in a transparent, predictable and least restrictive way in order to keep countries open to investment and

to reap the benefits of globalization. Furthermore, foreign investors must be treated equal regardless of their nationality. In our view the OECD should approach the topic through fact based analysis, increased dialogue and more high-level public outreach to promote open investment policies while meeting legitimate national security concerns.

A. Analysis, review, dialogue, guidelines

19. The OECD paper *“Freedom for Investment, National Security and “Strategic” Industries”* shows that the approaches towards defining national security and sectors that are vital to it differ considerably across countries. Most governments regard arms production as vital to national security. Others also restrict foreign investment in sectors such as communications or transport for security reasons and for some self-sufficiency in energy or access to raw materials are security concerns that justify restrictions.

20. Moreover, security related restrictions and procedures take very different forms. For example, some countries publish lists of restricted sectors while others apply general screening processes or approval procedures. Security reviews seem to be more transparent in some countries than in others. The level of discretion given to the reviewing administration differs considerably as well as definitions of foreign control and the restrictions that can be applied to foreign investment.

21. BIAC believes that the OECD is the ideal organization to shed more light on how countries regulate foreign investment because of its expertise on investment issues and its access to relevant information. In our view the OECD should analyse countries’ statutory regulation applied to foreign investment and in particular assess the actual impact that different legal approaches have in practice on the openness of countries as well as indicate the costs and benefits associated with different policy approaches towards foreign investment.

22. OECD business is concerned that overly broad definitions of national security are used for purposes other than that for which they were intended. We suggest that the OECD examines trends and based on this analysis develops a set of recommendations/guidelines for best practices that balance legitimate national security concerns with countries’ existing international obligations to allow the free movement of capital. The recommendations/guidelines should include guidance on how to ensure that regulation aimed at protecting national security be applied in a transparent, predictable, non-discriminatory and least restrictive way which at the same time ensures the confidentiality of business information. In addition, countries should share experience on how to safeguard national security without restricting investment in the first place. In the future the OECD should conduct country peer reviews to benchmark countries’ policies against the agreed recommendations/guidelines.

23. As to the protection of strategic sectors, BIAC does not see any convincing argument that justifies foreign investment restrictions in areas not related to national security. Also empirical evidence seems to suggest that protecting “national champions” impacts in the long run adversely on consumer and shareholder interests rather than improving economic efficiency. Nevertheless, governments have renewed their efforts to protect strategic sectors and “national champions”. BIAC suggests that in particular with regard to the protection of strategic sectors, the OECD provides analysis on the economic costs and benefits and engages countries increasingly in a discussion on how to achieve strategic goals without resorting to foreign investment restrictions.

24. Non-OECD countries are of increasing importance to foreign investors. Likewise, companies from emerging markets become ever more important investors in the OECD area. It is therefore very important that the OECD encourages major non-OECD countries including China, India, and Russia to participate in any future work related to policies towards foreign investment for national security and other strategic reasons.

B. Public outreach

25. Although the OECD is the international body for promoting open policies towards international investment, the Organization has so far not been visible in the public debate about cases of investment protectionism, many of which received considerable international public and media attention.

26. BIAC believes that the Organization and in particular its leadership should become more vocal in warning against the dangers of government intervention in international trade and investment. In our view the OECD must do more to support sustainable economic growth and development through the promotion of open markets and appropriate policy frameworks to. OECD analysis and leadership engagement in public debates can provide valuable support for policy makers, public officials, companies and academics in a number of countries that need good arguments to defend the case of open market policies against increasing pressures from protectionists.