

Unclassified

DAF/INV/WD(2008)17



Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

07-Nov-2008

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
INVESTMENT COMMITTEE**

**DAF/INV/WD(2008)17
Unclassified**

Eighth Roundtable on Freedom of Investment, National Security and "Strategic" Industries

Summary Report by the Secretariat

8 October 2008

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JT03254747

Document complet disponible sur OLIS dans son format d'origine
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FREEDOM OF INVESTMENT, NATIONAL SECURITY AND 'STRATEGIC' INDUSTRIES

Roundtable, 8 October 2008, OECD Headquarters Paris

SUMMARY OF DISCUSSIONS PREPARED BY THE SECRETARIAT

1. Since early 2006, the Freedom of Investment (FOI) project has provided a forum for discussing how governments can reconcile their duty to safeguard essential security and other interests of their people with the need to protect and expand an open international investment system. This note summarises the views and information contributed by both OECD and non-OECD government participants in the Eighth Roundtable. In addition to the 30 OECD members and the 11 non-member adherents to the OECD investment instruments, the Roundtable benefitted from the participation of several representatives from Russia and from the Qatar Investment Authority.

2. The Roundtable discussion was held during a particularly grave phase of the financial crisis and these external events coloured the discussions. Although the Roundtables deal with policy tools that are not used on the front lines of short term crisis management, investment issues are likely to be of central importance in managing the crisis' medium term, collateral impacts – notably for countering protectionist pressures that may emerge in response to shrinking output, job losses, changes in corporate ownership, and other structural adjustments stemming from the crisis. Overall, Roundtable participants reaffirmed the importance of maintaining and strengthening freedom of investment in the face of protectionist pressures and agreed to a new strengthened policy peer review process for promoting good investment policy principles and practices.

Co-operation with the International Working Group of SWFs

3. The International Working Group of Sovereign Wealth Funds and the OECD have been working on complementary sets of guidance in relation to sovereign wealth funds (SWFs). The OECD guidance focuses on developing principles and good practices for recipient country policies toward SWFs. The International Working Group (IWG), facilitated by IMF, has produced generally-agreed policies and practices for enhancing the transparency and governance of SWFs (GAPP or “Santiago Principles”, named after the city where they were adopted).

4. The work of the two has been closely co-ordinated since the IWG's first meeting in May 2008. David Murray, Chair of the IWG drafting group, presented the *Santiago Principles* to the Roundtable. He stressed that the IWG's GAPP is a voluntary agreement that in no sense replaces laws, which each of the SWFs are bound to follow, including for example, disclosure requirements. The guidance does aim to encourage transparency and to improve SWF governance.

5. Mr. Murray stressed a few lessons learnt from the IWG experience: 1) the SWFs show tremendous diversity (different legal status, reporting, purposes, and different levels of accountability) 2) SWFs are not government-owned in the traditional sense (the government is not the legal beneficiary) although they may be a part of government, and are funded by government, 3) when investing, the SWFs are in competition among themselves and with other categories of investors, and 4) some special concerns arise for new SWFs due to start-up transitions (investing track records also are important).

6. Roundtable participants welcomed the GAPP. They noted that it was a major step toward building trust and confidence between home and recipient countries and expressed their hope that the IWG – or a successor standing group – would continue to exist as a co-ordinating body for SWFs. David Murray responded that a “Formation Committee” had been established to explore whether and how such a co-ordinating body should be established. Regardless of the outcome of this discussion, participants hope that SWFs will continue to be able to participate in the Roundtables (sovereign wealth funds from Australia, Norway, Russia and Qatar were represented at the Roundtable).

Strengthening peer monitoring

7. Peer surveillance of host country investment policies has existed since 1961 relative to the legally-binding obligations that member countries undertake under the OECD *Codes of Liberalisation of Capital Movements and of Current Invisible Operations (Codes)*. The plan now is to extend the surveillance to a broader range of commitments, including on the newly-agreed principles to approach national security considerations and on keeping markets open to foreign investors including SWFs; to make its procedures more robust; and to continue the FOI Roundtable tradition of involving non-member countries, including countries which have SWFs, in the surveillance process.

8. The Roundtable agreed to a new set of procedures for doing this, including a stricter notification procedure, a written question and response procedure prior to the actual peer monitoring discussion (“Tour d’horizon of recent developments”), with a stronger license for the Secretariat to pose challenging questions, and the production of a public record of the discussion. For details, see the Annex.

Tour d’horizon of Recent Developments

9. The *Tour d’horizon* covered recent developments in 6 countries: Australia, Canada, Germany, Japan, the United States of America, and Brazil:

- **Australia** shared information about its investment review procedures and recent cases involving investments from China. As discussed at the last FOI Roundtable, Australia has adopted *Principles Guiding Consideration of Foreign Government Related Investment in Australia* to guide the review procedures. Several questions were raised in this regard. For the principle on “operational independence” of the investor from its government, Australia noted: “We tend to examine this ‘in the negative’ (by trying to see if dependence exists).” As to its principle on competition effects of such investments, Australia “tends to rely” on the Australian Competition Authority’s decisions. Australia was also asked what steps are taken to evaluate impacts of a proposed investment on strategic and security interests. For the definition of “strategic and security interest”, Australia clarified: “we include critical infrastructure, anything specifically defence-related, and then there are some specific requirements for nuclear industry related matters.” Asked about pressures on government regarding recent Chinese investments or proposed investments in Australia, the Australian delegate noted that Chinese investments are getting much “unmerited media attention” and that the Australian Foreign Investment Review Board looks “at track record, mandate, reporting requirements. No Chinese investments have been blocked as a result of the Principles.”
- **Brazil** confirmed that Petrobras’ decision to stop its planned sale of Potash mine rights to a Canadian company was the result of purely commercial considerations. Asked to identify and explain the legal basis for the government’s action, and whether such a legal basis has been notified under the OECD National Treatment Instrument, Brazil stated that the government had exerted no pressure on Petrobras to stop the sale. Brazil also noted that the Canadian company already has several mining operations in Brazil. The experience raised the important issue of the

influence that government could have on commercial transactions, and the care necessary to avoid influence where it is not mandated or needed.

- **Canada** described the decision to block a foreign investment proposal in the Canadian space industry under the Investment Canada Act. This is the first time Canada reached such a decision. Canada stressed that the *Investment Canada Act* was the sole source of the decision. The Act contains a list of factors (in Section 20) that are used to assess an investment on the basis of its “likely net benefit to Canada”. The Minister’s decision to block the proposed investment was based on these factors and does not signal a new policy direction. Canada also described the recommendations stemming from the *Competition Policy Review Panel* as they relate to Canada’s inward FDI policy. Canada noted that its government has recently been carefully examining the possibility of creating a national security review mechanism for foreign investments. However, no specific proposal has been put forward prior to the dissolution of Parliament due to an election call.

- **Germany**’s cabinet has approved a draft amendment to the Foreign Trade and Payments Act and its implementing regulations, aiming to spell out the legal bases for government screening of new incoming investments. Currently still draft, the proposal is only available in German (online at <http://www.bmwi.de/BMWi/Navigation/Service/gesetze,did=223394.html>). Germany was asked to provide more information about the proposed review board, its membership and decision-making, as well as the notification procedures. Germany was asked to define its terms “public security” and “public order”, to justify the inclusion of “public order”, to clarify reliance on Article 58 of the EC Treaty, and to provide a copy of the draft law in English or French. Germany explained the scope of application: the proposal distinguishes investments coming from within the EU, generally exempting these from the review procedure. The screening “is applicable to investors from outside the EU (and outside of EFTA) who wish to acquire 25% or more of the voting rights of a German company.” In addition, “in order to avoid circumvention of the legislation, investors from inside the EU would also be subject to review procedures if a shareholder from outside holds 25 % or more of the rights to vote of the EU investor.” Much of the discussion concerned whether these criteria for applying review procedures could be discriminatory. The European Commission suggested that it will review the law when final in order to assure its legal basis. Germany was asked whether the proposal fully responds to the principles of accountability (including international accountability) and non-discrimination (including that specific measures taken should be based on specific circumstances of the investment which poses a risk to national security), as they are set out in the recently-developed *OECD Guidelines for Recipient Country Investment Policies Relating to National Security*. Germany also offered to consult at home on other questions and to return to the Roundtable with answers. The draft law, already discussed at several previous FOI Roundtables, will continue to receive attention from participants at future Roundtables.

- **Japan** reported on its first decision to block an investment proposal based on Article 27, paragraph 5 of Japan’s Foreign Exchange and Foreign Trade Act. Jointly, the Minister of Finance and the Minister of Economy, Trade and Industry found the “possibility that the maintenance of public order is disturbed.” The decision concerned the investment proposal by a foreign investor in the Japanese electrical power industry. Japan noted that the sector was critical infrastructure and that the target company played in a key role in the “nuclear fuel cycle in Japan.” The Japanese authorities feared that, under pressure to meet its new owners’ high demands for annual returns, the target company would under-invest in long-term projects for new sources of energy production, and that as a result the “stable supply of electric power” would not be assured. The issue as to whether Japan’s review procedure conforms to the principle of “last resort” was raised. The principle states that restrictive investment measures should be used, if at all, only as a

last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

- The **United States** explained that a new set of implementing regulations is in the process of being developed for CFIUS reviews. Following the rules of administrative procedure, public comments on the draft regulations were invited between April and June 2008. Treasury Department reactions to comments received will be published accompanying the final version of the implementing regulation, and the comments themselves are also available on a website <http://www.treas.gov/offices/international-affairs/cfius/>. Law requires final regulations in 2008. Asked how likely is it that Congress will attempt to “force a review” in a specific case, the US delegate affirmed that there is no mechanism for such influence – Congress cannot request or mandate CFIUS reviews. He further noted that CFIUS does not brief Congress on ongoing investment reviews, but must report to Congress after each review and investigation.

10. The Chair concluded this session by reminding participants that the aim of the *Tour d’horizon* is to review developments, share experiences and to assure that what participating countries do when applying or considering restrictive investment measures conforms to their international investment commitments: the long-standing OECD general investment policy principles and the new *Guidelines for Recipient Country Investment Policies Relating to National Security*.

Accountability in Applying National Security-Related Investment Policies

11. Detailed guidance on accountability, the final principle completing the OECD *Guidelines for Recipient Country Investment Policies Relating to National Security*, was agreed. [The completed guidance is now¹ available on the OECD website (<http://www.oecd.org/daf/investment/foi>). It was presented¹ by the OECD Secretary General to the International Monetary and Financial Committee (IMFC) during the IMF/World Bank meetings on October 11, 2008. References to the completed guidance made during the IMFC can also be found on the OECD website above.]

Foreign Government-Controlled Investment

12. The discussions of foreign government-controlled investment reaffirmed an earlier finding that there is no record of serious security problems in recipient countries related to investments by foreign government-controlled investors. Moreover, participants recalled the significant benefits that such investments can bring to host societies. One remarked that investment flows reinforce a “commonality of interests” and a mutual dependence among states, thereby raising the costs and reducing the net incentives for international conflict.

13. The discussions also covered: 1) distinguishing between commercial and political investments; 2) competition concerns; and 3) foreign sovereign immunity. Each of these is summarized in turn below.

Political versus commercial objectives

14. In a broad-ranging discussion, there was evident agreement that, if foreign government-controlled investments were motivated by political rather than commercial objectives, then these investments could be a source of concern for recipient countries, as stated in the Ministers’ *OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies*.

¹ This occurred after the 8 October 2008 FOI Roundtable.

15. However, the discussion also highlighted the difficulties of making clear separations between political and commercial motives. This is particularly true if one uses a broad definition of “political motive” – that is, any investment made primarily for the purpose of furthering any public policy goal, including macroeconomic, fiscal management, health care or pensions management objectives.

16. One participant suggested that such motives could be seen as falling on a continuum; this might describe reality better than the “either-or” scenario. On one end, there are political motives that are very clearly a source of concern: for example, gaining access to key defence or intelligence assets, or achieving geo-political goals. On the other, there are objectives that are narrowly focused and purely financial; these seem largely innocuous. Several participants noted that sectoral considerations were also important in determining whether possible political motives should be considered – an investment in military technologies would be more sensitive than an investment in consumer goods. There were also concerns expressed with respect to the definition of government-controlled investors in the sense that the state may not have a majority interest but still may control or significantly influence the activities. This would suggest that a typology needs to be developed to differentiate between the various types of state-controlled investors. There was broad agreement that transparency about the goals of foreign government-controlled investors would go a long way in helping recipient countries assess motives. The IMF representative recalled that the Santiago Principles ask SWFs to be transparent about their objectives.

Competition concerns

17. Many governments share a view that the market economies remain the best way to reliably deliver economic growth, high standards of living, job creation and innovation. A number of participants expressed concerns that acquisitions by foreign government-controlled investors could unwind the thrust of their earlier privatization policies. Some also expressed broader reservations about the impact of such investments on competitive processes and the efficiency of market allocation.

18. In particular, there were concerns related to the ability of government-controlled investors to insulate themselves from market forces through a variety of techniques – direct subsidies, hidden subsidies (e.g. tax expenditures, special arrangement in government procurement) and implicit financial guarantees. There was also concern that some state-controlled investors are immune from takeovers (e.g., through golden shares), which lowers competition for corporate control. Participants agreed that representatives of the OECD Competition Committee should be invited to the next Roundtable to discuss whether there is interest in pursuing joint work in this area.

Foreign sovereign immunity

19. Foreign sovereign immunity is “the immunity of an agent or an entity controlled by a foreign government from the jurisdiction of local courts and the local agencies of law enforcement”. This area of law is very old, but in recent decades it has evolved rapidly. Main trends in relation to foreign government-controlled commercial activity include: 1) changes in national law that are intended to exclude the commercial activities of state actors from the protections of immunity; 2) international treaties and conventions that do likewise.

20. One Roundtable participant representing a government that is both a home and a recipient country for international investment made two points about foreign sovereign immunity:

- His government hoped for greater predictability in this area, meaning that all market participants understand the legal status of foreign government-controlled investors (including the investor itself). At the present time, diversity of national laws and evolving jurisprudence make it hard for both foreign government investors and their business partners to predict the extent of foreign

sovereign immunity. Several other Roundtable participants confirmed that this is an area relevant for international investment law that is not well-understood by policy makers nor by market participants.

- His government sees a trend toward more litigation targeting foreign government investors.

21. Roundtable participants confirmed the value of documenting different national law and practices, and principles set forth in international treaties and conventions. This is a possible area for more in-depth discussion at future Roundtables.

ANNEX.
STRENGTHENED PROCEDURES FOR PEER MONITORING

The OECD Investment Committee agreed to a more robust peer monitoring process in the Roundtable's "*Tour d'horizon* of recent developments", as follows:

A. Countries are invited to notify, at least one month in advance of the Freedom of Investment (FOI) roundtable in Paris any relevant developments, in particular new regulations (in force or debated) and decisions and justifications to block particular FDI transactions. For those governments which have adhered to the OECD investment instruments (Codes of Liberalisation and Declaration on International Investment and Multinational Enterprises and related Decisions), notification of measures taken that have a bearing on foreign investment is an obligation.

B. The Secretariat will continue to fill information gaps using press reports and other sources. It is given the mandate to pose specific questions to the countries concerned, including about: 1) factual information; 2) assessment of (a) compatibility with rights and obligations under the OECD Codes (and the OECD National Treatment instrument) as appropriate; and (b) consistency with the FOI's principles for designing and implementing investment safeguards (non-discrimination/case-by-case risk assessment; transparency/predictability; proportionality; accountability).

C. The *Tour d'horizon* documents are issued three weeks before the FOI roundtables. Countries would have one week to respond to the Secretariat's questions in writing before the roundtables. Where they do not respond or their responses are not persuasive, the Bureau endeavours to give special attention to a probing discussion at the FOI roundtable on the questions raised by the Secretariat. Responses are distributed to delegations before the FOI roundtables, and later on OLIS as addendums to the *Tour d'horizon* documents. Sufficient time will be allocated to their discussions at FOI roundtables.

D. As part of the reports giving accounts of the FOI roundtables which the Secretariat posts on the web, there will be a summary record of the *Tour d'horizon* discussions under the Secretariat's responsibility. The summary record will be reviewed by the participants before publication for comment. Publication will be subject to the necessary respect of confidentiality of sensitive business and government information related to individual transactions which may be or have been under national security and other review procedures.

E. Investment measures (laws and regulations) taken for essential security and public order reasons by countries adhering to the OECD National Treatment instrument are published on the OECD website in the so-called Transparency list of the instrument. For the time being, this information is provided in a very succinct form and it does not include partner countries that have not adhered to the instrument. As foreseen in the Committee's PWB 2009-10 submission, the Secretariat will start developing a more detailed and comprehensive public database of such measures. Those whose laws and regulations are reported will be provided opportunities to correct and update their descriptions to ensure accuracy before they go on the website.

F. Non-OECD adherents to the OECD Declaration and other major emerging country partners consistently take part in the FOI Roundtables. Extending this tradition of openness, the Committee will wish to invite other non-OECD countries whose investors, including SWFs, might feel unfairly affected by recipient country measures, to attend all or part of the *Tour d'horizon* discussions; invitations are subject to the necessary respect of confidentiality of sensitive business and government information related to individual transactions which may be or have been under national security and other review procedures.