



SIXTH ROUNDTABLE ON FREEDOM OF INVESTMENT, NATIONAL SECURITY AND “STRATEGIC” INDUSTRIES

Paris, France – 13 December 2007

Summary of the discussions by the Secretariat

Since early 2006, the Freedom of Investment (FOI) project has provided a forum for discussing how governments can reconcile their duty to safeguard the essential security 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 Roundtable VI, the first meeting under Phase II of the FOI project. Phase II consists of four components: 1) peer monitoring through *tours d’horizon* of national developments at the Roundtables; 2) in-depth policy discussion of selected national security topics; 3) surveys of the benefits of FDI in selected national security-sensitive industries; 4) identification of lessons learnt and good practices that contribute to regulatory proportionality, transparency and predictability and accountability, based on country submissions and exchanges of experience.

Roundtable VI discussions covered recent policy developments; the transparency and predictability of investment policies addressing essential security concerns; and the benefits of open investment markets for energy security. In addition, a consultation was held in which business and trade union partners discussed the policy issues raised by investments of Sovereign Wealth Funds (SWFs).

Recent policy developments

Japan and the United States reported on recent changes to their investment policies. Changes involve clarifications or refinements of existing investment review policies relating to essential security interests. France reported that the implementing regulations issued in 2005 did not result in blockage of the transactions reviewed. Hungary explained that the amendment adopted in October 2007 to legislation on business associations of strategic importance for the security of public supply did not include provisions discriminating against foreign government controlled investors. Germany and Russia described possible, security-related revisions to their investment laws and received feedback from participants. Several participants stressed the fact that these actual or prospective changes are set against general policy stances that welcome foreign investment. The Roundtable did not produce evidence of any broad movement toward more restrictive investment policies.

The following thematic issues arose in the course of these discussions:

- *Role of investment policy in broader policy frameworks for safeguarding essential security interests.* Among the 40 countries adhering to the OECD Declaration on International Investment and Multinational Enterprises, 13 report that they do not depart from national treatment on security grounds. Others have sectoral policies that restrict foreign investment in a very narrow range of activities (e.g. in Sweden, they are limited to a partial restriction on foreign investment in war munitions). Thus, these countries implicitly adopt the view that investment policy has only a very small or non-existent role to play in the broader policy frameworks for national security. This broader framework includes national defence and intelligence capabilities, police and judicial authorities, other measures for protecting public health and safety and sectoral policies designed to preserve the viability and integrity of certain production systems. Because much of the discussion in the Roundtables focuses on the experiences of countries with active investment policies in this area, the Chair advised the Roundtable not to lose sight of this “silent majority” of countries that assign little or no role to investment policy in protecting national security.
- *Deciding which investments to subject to an approval procedure.* Participating countries agree that national security concerns are “self judging”. However they have diverse approaches to deciding which investments should be subject to scrutiny on national security grounds. Most countries adopt fairly simple rules for making this decision. These often involve sectoral lists and/or other triggers such as size of investment or control thresholds. The narrowness or breadth of the investment activity covered by these lists or trigger mechanisms was considered to be an important issue for the design of procedures. Another approach involves case-by-case consideration of investment proposals. These are called to the attention of the review panel through voluntary notifications by potential investors or by the review panel itself on the basis of a narrow range of national security criteria. The “regulatory quality” concerns that were identified with respect to the design of these review procedures include: 1) transparency and predictability and 2) reducing regulatory burden (i.e. avoiding, to the extent possible, costly reviews and possible blockage of investments that do not, in fact, threaten essential security interests).
- *National security expertise on review panels.* The issue of how review panels acquire access to the intelligence and national security expertise needed to make their assessments was raised. In several countries, representatives of national defence and intelligence agencies sit on the panels. France notes that its panel members have appropriate security clearances.
- *Repertoire of responses.* Some participants stressed the need to give approval panels a repertoire of possible responses to investments that raise security concerns. Several countries allow host governments and investors to come to formal agreements on how such concerns can be addressed, short of blocking the investment. That is, they allow for mitigating risks through agreement with the parties to a transaction to avoid the need to block transactions in response to a perceived risk. This flexibility was generally deemed to be useful because it allows responses to be calibrated to the nature and size of the perceived security threat.
- *Level at which decisions to block an investment are taken.* The decision to block a foreign investment is an important one since it inhibits the full expression of property rights that are of central importance for a healthy market economy. Some participants expressed the view that such decisions, given their importance, need to be taken at a high political level.

The discussions of regulatory proportionality scheduled to take place at Roundtable 7 will provide a further opportunity for participants to share views on these issues.

Maintaining open investment environments – focus on transparency and predictability

Transparency is the cornerstone of a well-functioning regulatory process. For the investment policy community, it is primarily understood to mean making relevant laws and regulations publicly available, notifying concerned parties when laws change and ensuring uniform administration and application. For an increasing number of practitioners, it may also involve offering concerned parties the opportunity to comment on new laws and regulations, allowing time for public review and providing means to communicate with relevant authorities. Procedural transparency and fairness refers to how clear policies are and how uniform in their application. Reporting on outcomes of investment policies (e.g. on decisions on particular cases and general information about how investment policies have worked in practice) provide the information necessary to make accountability work.

Roundtable participants shared information about policies and practices that affect the transparency and predictability of investment policies addressing essential security interests. Broadly speaking, participating countries show very similar practices in terms of publication of laws. Most countries make primary and secondary (or subordinate) legislation available in a centralised register and this register is nearly always available on internet. Quite a few countries translate investment legislation into foreign languages.

Practices are more varied with respect to prior notification and consultation. While most countries provide for prior notification of laws before changes are made, consultation practices are quite variable. Several do not engage in any consultations on investment matters. Others have established advisory councils that are specifically designed to collect foreign investors' views on investment-related policies. For example, Korea operates an advisory council composed of 33 foreign investors. Others note that their consultations reach foreign investors via their membership in national business associations.

Countries seek to enhance procedural transparency and clarity through a variety of measures. As noted above, they have varying approaches to deciding whether a proposed investment should be subject to an approval process. They also differ in the amount and type of guidance provided to review panels on how investment proposals should be evaluated. These choices influence the transparency and fairness of the procedures. Some delegates asserted that simple sectoral lists or other "trigger mechanisms" increase transparency and user-friendliness for investors. Others are of the view that, given the inherent complexity of the interactions between investment and essential security interests, publishing lists of evaluation criteria (as narrowly focused as possible on essential security interests) best serves the goal of transparency, while also reducing regulatory burden. Other measures commonly used to enhance procedural transparency and fairness include time limits for consideration of cases, 'silence means assent' rules and special arrangements for protecting confidential or commercially sensitive information.

Disclosure of information on the outcomes of investment policies addressing essential security interests is an important first step for assuring accountability. At the same time, disclosure of information about review procedures is often limited by the fact that such procedures can involve both commercially-sensitive and classified information. A few countries noted that they occasionally make public announcements, especially when a decision to block an investment is taken. One country's investment authority publishes an annual report containing information and statistics on its investment approval procedure (e.g. number of cases considered, general statistical characterisation of outcomes, average time taken to process cases).

The benefits of open markets for energy security

Roundtable participants heard and discussed a report from the OECD Competition Policy Secretariat on the role of competition policy in promoting energy security. The report does not attempt to establish a precise definition of energy security, but notes that it is mainly about managing vulnerability to supply disruptions and associated price spikes. These disruptions can arise from such sources as “political turmoil, armed conflict, terrorism, piracy, natural disasters, nationalism and geopolitical rivalry.”

The main conclusion of the report is that competitive markets, including markets allowing entry of foreign competitors, help reduce vulnerabilities in the energy sector. They do this in several ways. First, competitive markets – which, by definition, involve rivalry among incumbents and the threat of new entry – promote diversity of supply. Second, competitive markets provide incentives for making investments that contribute to the resilience of energy markets and their ability to adjust to shocks. These would include investments in spare or surge capacity in the electrical power sector or in emergency stocks in oil and gas. Third, a broad, open market creates interdependence among local markets and lowers the risks of supply shocks for each locality via diversification effects. In other words, by connecting themselves to a broader market and more diversified sources of supply, various local markets are able to pool their risks of supply disruptions. Fourth, the market information systems that tend to arise in competitive markets increase the ability of the market to adapt quickly to supply shocks.

What role can policy play in promoting energy security? First, open investment policies enhance energy security. They will help consumers benefit from the diversity of supply, adaptability and resilience of a healthy market economy which go with open competitive markets. For example, in Europe, according to the report, a continent-sized energy market would be a better assurance of security than a collection of local monopolies. Second, effective competition policy is needed, including pro-competitive practices in the regulation of price, entry and ways of doing business in the energy sector. It also includes safeguards against anti-competitive mergers, whether initiated by domestic or foreign investors. The report views vertical mergers as being a particular source of concern because they might allow incumbents to hinder non-discriminatory access by potential competitors to essential facilities.

The report also discusses competition policy’s limitations in contributing to competitive energy markets and enhanced energy security. Entities that are subject to direct or indirect government control may not be fully subject to competition law enforcement. Anticompetitive conduct might be shielded by sovereign immunity, and in some jurisdictions competition law may treat state-controlled enterprises differently than private entities. These limitations may be of particular note in the energy sector, where there are many state-owned enterprises. This situation poses complex issues for international competition law, which are still being explored in various jurisdictions. The risk that sovereign immunity could shield anti-competitive conduct might be factored into the decision under national competition law to clear or block a merger or acquisition. But where the prospect to use competition law remedies against collusion or abuse is limited, this could create a motivation for using restrictive investment policies as a substitute for them.

Consultation on Sovereign Wealth Funds (SWFs)

BIAC and TUAC contributed their views on the place that host country policies toward SWFs occupy within the broader policy tableau being considered in the FOI project. The discussions highlighted the diverse contributions that SWFs can make to the development of their home countries. These include shielding the home economy from volatility in commodity markets of critical interest for the country, diversifying national wealth, optimising governments’ risk-return profile on national wealth and increasing transparency and accountability by enhancing scrutiny of public finances. In host countries, SWFs’ portfolio and direct investments stimulate business activity and create jobs. SWFs’ recent injections of capital into financial intermediaries – amounting to US\$35 billion since early 2006 and to US\$26 billion

over the previous six months – were stabilising for OECD banking systems because they came at a critical time when risk-taking investors were scarce and market sentiment was pessimistic. Moreover, many OECD companies have had very positive experiences with sovereign funds that have shown themselves to be reliable, long-term investors.

Stakeholders agreed that the policy treatment of state-controlled investors – including SWFs, but also state owned enterprises – has an important place in broader discussions under the FOI project. TUAC recommended OECD dialogue with SWFs and their home governments on the joint implementation of the OECD Guidelines for Multinational Enterprises (a government-backed code of conduct for international business), the OECD Guidelines on Corporate Governance of State-Owned Enterprises, as well as relevant OECD principles for pension governance and asset management. BIAC expressed its strong support for coordination of IMF and OECD analyses and sharing of policy experiences with a view to developing guidance on measures that SWFs and recipient countries can take to boost mutual confidence and trust.

These issues will be explored further at a conference being organised by OECD and the City of London, with the participation of the IMF. The conference, titled “SWFs in the Global Investment Landscape: Building Trust” will be held in London on 31 March 2008.

Next Roundtable

The Seventh Roundtable will be held at the OECD on Wednesday 26 March 2008. In addition to continuing the monitoring of new developments, it will: 1) discuss practices aimed at meeting the principle of proportionality of the regulatory measures relative to the essential security objective pursued; 2) consider selected issues such as “critical infrastructure”; and 3) develop a progress report for release in advance of the upcoming OECD Ministerial Meeting and other major international meetings.