FOREIGN GOVERNMENT-CONTROLLED INVESTORS
AND RECIPIENT COUNTRY INVESTMENT POLICIES: A SCOPING PAPER

This document has been prepared for discussion under item 3.c. of Roundtable IX on “Freedom of Investment, National Security and ‘Strategic’ Industries”. Roundtable participants are asked, in particular, to provide their views on whether any further exploration of issues related to foreign government controlled investors is needed to support future discussion in FOI Roundtables.

The document has been revised in response to further comments received from delegates by written procedure by November 18. The document was also made available for discussion to delegates at the 12th meeting of the Working Group on Privatisation and Corporate Governance of State-Owned Assets on the 18 November 2008. Revisions are presented in track changes mode.

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“GOVERNMENT-CONTROLLED INVESTORS AND RECIPIENT COUNTRY INVESTMENT POLICIES: A SCOPING PAPER”

... we do not believe that the sensitiveness and concerns of Western governments towards these [sovereign wealth] funds are justified ... nor do we believe that these governments need to introduce new laws governing those funds because they have enough laws and regulations ... . But all this should not mean that the ... funds should remain idle and take no action. We insist that these SWFs must not downplay the concerns of Western countries and should respond with measures that could contribute to alleviating those fears and concerns.

Jassim Al Manai, Chairman of the Arab Monetary Fund

“our government has not been very transparent for the past 5,000 years or so... we are trying... we are learning... But we don’t have horns growing out of our heads.”

Xiqing Gao, President and Chief Investment Officer, China Investment Corporation

Concerns raised in relation to Sovereign Wealth Funds mainly reflect speculation on whether some of the funds operate with hidden political agendas... But to put these concerns into perspective, there exists to my knowledge no evidence of Sovereign Wealth Funds investing for other motives than maximizing financial returns ....

Kristin Halvorsen, Minister of Finance, Norway

I. Introduction

1. This scoping paper was prepared to support multilateral discussions of recipient country investment policies towards foreign government-controlled investors (FGCIs) at the eighth Freedom of Investment (FOI) Roundtable, convened under the auspices of the OECD Investment Committee. The FOI project promotes non-discriminatory treatment for foreign investors and the development of effective recipient country policies that are both open to foreign investment and capable of addressing any genuine concerns or risks posed by such investments. This paper also summarises contributions made by participants at the eighth Roundtable and describes their views on subjects for future Roundtable discussions.

2. Since 2006, experience-sharing among recipient countries under the FOI project has not revealed any serious problems related to investments made by foreign government-controlled investors. This

trouble-free record may reflect self-regulation by these investors (who may avoid investments in politically-sensitive or risky sectors) and policy frameworks in recipient countries that may help to eliminate problems before they arise. It also explains why some observers believe, in view of the sometimes harsh treatment these investors receive in recipient country media, that foreign government-controlled investors are the targets of unfounded suspicions and fears.

3. The quotes above from officials of the Arab Monetary Fund and China Investment Corporation show a determination to respond to recipient countries’ concerns and to learn how mutual confidence and trust between home and recipient countries can be promoted. The discussions of foreign government-controlled investors under the FOI project are underpinned by this same spirit of co-operation, recognition of other countries’ concerns and the desire to learn how to build mutual confidence and trust.

4. For the purposes of this paper, a “government controlled investor” is defined as any investment entity that is wholly or partly owned by a government. The definition covers inter alia state-owned enterprises (SOEs), most public pension funds and sovereign wealth funds. Box 1 presents more detailed definitions of these entities. In addition, foreign governments also have other ways of influencing investors (such as through golden shares) and there are differences in degrees of government control (including via mixed public-private ownership of companies). Moreover, these categories of government-controlled investors are not mutually exclusive (many fit into more than one category) and their objectives and organisational arrangements evolve over time. Participants at the 8th FOI Roundtable expressed an interest in exploring in greater detail the typology of government control and influence and the implications that this may have for recipient country policies.

5. The issues and concerns raised for recipient countries by foreign government-controlled investors depend on what they do and how they are organised. For example: What is their mission? What markets are they involved in? How do they relate to their controlling government (degree of control or influence, mechanisms of control or influence)? As is suggested by the definitions in Box 1, the different types of government controlled investors present different concerns. State-owned enterprises, for example, have strategic involvements in a variety of sectors (they “are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication”) and are tasked with looking after “a mix of social, economic and strategic interests” in their home countries. In contrast, according to an OECD financial glossary, the mission of pension funds is quite circumscribed (to accumulate “dedicated assets to

\[4\] In some countries, the assets of some public pension funds – especially those of civil servants and other public sector workers – are not owned by the government. The members have legal or beneficial rights over the fund’s assets. The funds set up by some governments to meet future social security deficits (public pension reserve funds) are usually government-owned. For a discussion of the differences between various legal and governance forms that public pension arrangement can take see “Governance and Investment of Public Pension Reserve Funds in Selected OECD Countries.” Juan Yermo, OECD Financial Market Trends, 2008.

\[5\] The International Working Group’s survey entitled Sovereign Wealth Funds: Current Institutional and Operational Practices (September 15, 2008) illustrates this point: Within the sample of sovereign wealth funds surveyed, a little over 10 per cent indicated they are a corporation established under company law. In addition, about 20 per cent of the sovereign wealth funds surveyed indicated that they explicitly aim to cover expected future pension expenditures. For more detail, see: http://iwg-swf.org/pubs/swfsurvey.pdf

\[6\] Quotes taken from preamble of Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries OECD, 2005. Also quoted in Box 1 of this document.
cover the pension plan’s liabilities”) and they engage in investment activities in order to achieve this mission.

6. While there are important differences among the different categories of foreign government controlled investors, they tend to raise a common set of concerns. Will these investors be used by their home governments to achieve inappropriate political goals, rather than to pursue “commercial” objectives? How does government control influence competition in the financial and product/service markets they are involved in? Does their status as an organ of a foreign government confer on them sovereign immunity and, if so, what does this mean for the orderly conduct of business in recipient countries and for the enforcement of recipient country laws?

7. This document proposes an initial approach to identifying the issues raised by foreign government controlled investors in order to help participants in the 8th “Freedom of Investment” Roundtable to identify priorities for future Roundtable discussions. The discussion is organised into the following sections:

- Political versus commercial objectives;
- Perceived risks for recipient countries of FGCIs’ investments;
  - Competition-related concerns;
  - Sabotage, espionage or impeding the implementation of host country policies;
  - Foreign sovereign immunity and legal accountability;
- Recipient country policies vis-à-vis government-controlled investors;
- FGCIs under the OECD investment instruments and in international investment agreements.

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7 Quote taken from Private Pensions: OECD Classification and Glossary. Definition of “public pension plan” and pension fund. Also quoted in Box 1 of this document.
Box 1. Forms of government control or influence

State-Owned Enterprise (SOE). The term “SOEs” refers to enterprises where the state has significant control, through full, majority, or significant minority ownership. State-Owned Enterprises are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication, whose performance is of great importance to broad segments of the population and to other parts of the business sector. The rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests.

Source: Preamble to the OECD Guidelines on the Corporate Governance of State-Owned Enterprises.

Sovereign wealth funds (SWFs) are defined as special purpose investment funds or arrangements, owned by the general Government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

Three key elements define an SWF:
- Ownership: SWFs are owned by the general government, which includes both central government and sub-national governments.
- Investments: The investment strategies include investments in foreign financial assets, so it excludes those funds that solely invest in domestic assets.
- Purposes and Objectives: Established by the general government for macroeconomic purposes, SWFs are created to invest government funds to achieve financial objectives, and (may) have liabilities that are only broadly defined, thus allowing SWFs to employ a wide range of investment strategies with a medium- to long-term timescale. SWFs are created to serve a different objective than, for example, reserve portfolios held only for traditional balance of payments purposes. While SWFs may include reserve assets, the intention is not to regard all reserve assets as SWFs.

Source: Annex 1 of the Santiago Principles

Public pension plans: These are social security and similar statutory programs administered by the general government (that is central, state, and local governments, as well as other public sector bodies such as social security institutions). Public pension plans have been traditionally “pay-as-you-go” financed, but some OECD countries have partial funding of public pension liabilities or have replaced these plans by private pension plans. A public pension fund refers to a public pension plan that accumulates dedicated assets to cover the plan’s liabilities. These assets are assigned by law or contract to the pension plan. Their use is restricted to the payment of pension plan benefits.

Source: Private Pensions: OECD Classification and Glossary.

Public Pension Reserve Funds: The defining feature of Public Pension Reserve Funds, which differentiates them from public pension funds, is that their ultimate beneficiaries (the general population) do not have legal or beneficial ownership over the reserve fund’s assets. Rather, the legal or beneficial owner is the institution that administers the public pension system (social security reserve funds) or the government (sovereign pension reserve funds).


II. Political versus commercial objectives

8. A dominant theme of recent discussions of recipient country attitudes and policies toward foreign government controlled investors relates to whether or not these investors are following “hidden political agendas” (see above quote of Norwegian Minister of Finance). A number of official statements have focused on the degree to which government controlled investors are driven by the same “commercial” motives that drive private investors. For example, the OECD Ministers’ Declaration on SWFs and
recipient country policies states that “if SWFs investments were motivated by political rather than commercial objectives, they could be a source of concern...” The Agreement on Principles for Sovereign Wealth Funds between the governments of Abu Dhabi, Singapore and the United States contains the following text: “SWFS investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly the geopolitical goals of the controlling government”. Yousef Al Otaiba, the Director of International Affairs for the government of Abu Dhabi, in a March 2008 letter to the US Treasury and to G7 governments, states that the “Abu Dhabi government has never and will never use its investment organisations or individual investments as a foreign policy tool.”

9. Thus, concerns about the mix of political and commercial objectives of government controlled investors appear to be widespread. The Chairman of Temasek Holdings, a Singapore-based sovereign wealth fund, describes and interprets recipient country concerns about political versus commercial objectives as follows:

The intuitive distrust of SWFs and their investment objectives arises from the assumption that SWFs are created for political objectives and not for optimizing returns on government reserves. This scepticism has at its roots the distrust of the political system and political governance of certain SWF governments.... Often, such fears also reflect other insecurities or perspectives coloured by the experiences within their own borders. In most countries, being state-owned simply means being state-directed and that often also means being political and non-commercial. In other cases, there is a clear distrust of government involvement in the economy among the thought leaders of society. These find expressions in the suspicion of foreign state-owned entities as well.8

10. This section explores the issue of the “political versus commercial” objectives of FGCIs. A “political objective,” in its broadest possible sense, refers to any goal related to the implementation of any aspect of public policy. A “commercial objective” refers to economic transactions motivated by the desire to earn money or reduce costs. The following additional points might be useful for consideration of this issue:

- **Government involvement in some form of “commercial” transaction is unavoidable**, though the exact nature and extent of these transactions will depend on the specificities of public policy. Commercial transactions by governments arise inevitably from numerous government activities, such as: 1) management of government cash, receivables and short term payment obligations (that is, short term public financial management designed to ensure adequate liquidity and earn maximum net interest on working capital); 2) accumulating the assets needed to honour obligations or acquire capabilities needed to carry out government programmes (e.g. making pension payments, delivering health care services); and 3) managing foreign exchange reserves. Thus, the implementation of public policy creates some need to engage in financial/investment activities. Countries will differ, however, in the extent to which their public financial management strategies involve foreign investments and in the type of foreign investment undertaken.

- **State-owned enterprises.** In addition to investment and financial activities related to the requirements of public financial management discussed above, some governments have established state-owned enterprises (SOEs). The preamble of the OECD Guidelines for the Corporate Governance of State-Owned Enterprises states: “Over the years, the rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests. Examples include industrial policy,

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regional development, the supply of public goods and the existence of so called “natural” monopolies.” These “social, economic and strategic” goals are likely to influence all aspects of the SOEs management, including its foreign investment strategy. Thus, foreign investments undertaken by a state-owned enterprise are likely to reflect both commercial/financial motives and the SOE’s broader objectives.

- Politics and commerce are not always neatly separated and not all political objectives will necessarily raise concerns in recipient countries. For example, the Mubadala Investment Corporation, an investment arm of the Abu Dhabi government, has recently agreed to invest in a hospital that will open in the Japanese city of Kobe. Through this investment, the Abu Dhabi government hopes to gain improved access to medical technologies. It also plans to send doctors to the hospital to learn organ transplant techniques and to acquire treatment capabilities for diseases common in the Middle East, such as diabetes. Thus, this investment advances both public (health) policy and commercial objectives. It is also worth noting that the OECD Guidelines for Corporate Governance of State-Owned Enterprises acknowledge that state-owned enterprises may pursue non-commercial objectives, but encourage governments to be transparent about these objectives.

11. Thus, the governments of all countries engage in “commercial” activities as part of the normal government operations (financial management, need to acquire strategic assets). Presumably, recipient countries will be more concerned about foreign governments’ pursuit of foreign policy or defence goals than their pursuit of short and long term public financial management or their attempts to acquire know-how or other assets needed for public services.

12. The participants at the eighth FOI Roundtable noted that political and commercial objectives exist in a continuum, with a substantial “gray zone” between the two extremes of pure commercial motives and unacceptable political motives. They also identified this subject as a possible subject for future Roundtable discussion, but stressed the need to recognize and support the progress made by other international bodies (e.g. the International Working Group on Sovereign Wealth Fund’s Santiago Principles; the OECD Guidelines on the Corporate Governance of State-Owned Enterprises) in creating guidance on transparency of objectives of government-controlled investors. Roundtable participants agreed to invite the Chair of the Working Group on Privatisation and Corporate Governance of State-Owned Assets (who had already written the Investment Committee Chair expressing a desire to explore areas of possible closer collaboration) to the 9th FOI Roundtable.

13. This remainder of this section addresses two additional questions:

- How credible are government commitments to pursue only commercial objectives?

- How can governments enhance the credibility of such commitments?

How credible are government commitments to pursue only commercial objectives?

14. Governments are special institutions and their distinctive governance structures are designed to help them to undertake their special functions – helping society to meet its collective needs (e.g. defence, investment in public goods and provision of public services). In order to do this, governments need to be aware of and responsive to a wide range of societal interests and to find politically-viable compromises among competing interests. Important elements of public governance for democratic societies include an electoral process with wide suffrage, the rights of citizens to organise for political purposes and rules for transparency and accountability (e.g. rules that prohibit certain forms of political influence such as bribery). When successful, their governance structures help governments undertake their mission in ways...
that promote prosperous and harmonious societies and that render them accountable to society at large (including to the taxpayers who ultimately bear the costs).

15. In contrast, businesses have governance structures that are designed to help them pursue a relatively focused set of objectives. Their primary objective is to maximize the value of the business to suppliers of equity capital (be they individuals, families, partners or shareholders) and their governance structures (e.g. rules for naming members of Boards of Directors and for members’ conduct and responsibilities) are specifically designed to keep them accountable to a relatively narrow group of people or organisations (e.g. owners and stakeholders such as employees and creditors) and focused on a relatively narrow range of tasks (e.g. profitably managing the business, obeying the law).

16. Thus, governments and business governments have fundamentally different functions and, for that reason, fundamentally different governance structures. When a private business “commits” to pursuing only commercial objectives, this commitment tends to be credible because its governance structure makes it credible. When governments undertake commercial activities, they remain answerable to a wide range of societal pressures that their governance structures are designed to take into account. For this reason, governments may encounter difficulties in making credible commitments to pursue only “commercial” objectives, since their raison d’être involves being sensitive to political pressures and to pursuing non-commercial objectives. However, governments have developed norms for governance practices that help them to make these commitments more credible. These are discussed in the next section.

How can governments enhance the credibility of such commitments?

17. The introduction to this section notes that, although governments’ overall mission is to look after the collective needs of society, they cannot, as they carry out this broader mission, avoid engaging in transactions that are “commercial” in nature. In addition to investment and financial activities related to the requirements of public financial management discussed above, some governments have, created state-owned enterprises or other state-owned investment arms. According to a 2005 OECD Survey, “the state remains a significant owner of commercial enterprises that operate in competitive markets. State ownership includes businesses in several sectors, notably utilities and infrastructure, with energy, transport and telecommunications being usually the most important industries.”

18. Thus, all governments have extensive experience of various types in financial and investment activities. Moreover, through the gradual accumulation of expertise in public sector management, governments have learned over time how to organise these activities in ways that reduce the scope for inappropriate political interference while maintaining political accountability. In doing so, they seek to enhance the effectiveness of government investment processes and to lower the public cost of capital. Guidance exists on how governments can manage their financial and investment activities through a variety of governance arrangements (e.g. by establishing relatively autonomous management commissions; by listing SOEs on stock exchanges with partial private ownership; by defining better board nomination procedures and better risk management systems and disclosure/reporting practices). OECD guidance in these areas includes the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The International Working Group (IWG) of Sovereign Wealth Funds has developed, with support from the

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10. As a complement to these Guidelines the OECD Working Group on Privatisation and Corporate Governance of State Owned Assets has recently launched an initiative to develop guidelines for the transparency and governance of state-owned enterprises that invest and operate internationally. It is expected that this effort will engage state-owned enterprises and ownership agencies from both member and non-member countries.
International Monetary Fund, a set of Generally Accepted Principles and Practices for sovereign wealth funds (also known as the Santiago Principles) which also deals with these issues.

19. Although governance practices of the type foreseen in the OECD and IWG guidance do not completely remove the possibility of home-government political interference, they can improve government-controlled investors’ focus on the pursuit of commercial objectives and enhance the transparency of their what their public policy mission is and of how they pursue this mission.

III. Perceived risks for recipient countries of investments by FGCIs

20. Participants at the eighth FOI Roundtable stressed the need to preface this discussion of perceived concerns associated with FGCIs with a clear statement that these investments can bring great significant benefits for both home and host societies. In addition to these investments’ economic benefits (e.g. diversification of investment portfolios for home countries and of sources of capital for recipient countries), Roundtable participants noted that such investments by FGCIs – and, indeed, international investments from all types of investors -- may cement ties between home and host countries and reduce the incentive for international conflict. Thus, with the right policy frameworks on both the home and the recipient side, these investments have much to offer.

21. While acknowledging these clear benefits, participants also wished to retain the risk management perspective of the FOI project and to focus on the perceived concerns or risks for recipient countries of investments by FGCIs. This section examines the following concerns or risks: competition-related concerns; sabotage, espionage or impeding the implementation of host country policies; and foreign sovereign immunity. As a general rule, the management of these risks will fall mainly on other policy communities – competition authorities, national defence and law enforcement – but there may also be a role for investment policy.11

Competition-related concerns

22. Roundtable participants acknowledged that FGCIs might pose concerns or risks for competitive processes and for market allocation. At the end of their discussion, they expressed an interest in exploring with a representative of the Competition Committee whether there is any mutual interest in clarifying the implications of foreign government controlled investors for competition and market allocation. It was agreed that a representative should be invited to the 9th FOI Roundtable.

23. Depending on the rules national competition authorities follow, they may or may not raise objections to investments by government-controlled investors, be they domestic or foreign. According to a 2006 report12 by the OECD Competition Committee, “it is widely agreed that the purpose of competition policy is to protect competition, not competitors, but there is less agreement on how to go about doing that. Agencies in many countries [focus] on the economic impact that conduct has on consumers and

11 Other policy areas, such as financial regulation and taxation, were not covered in this section because the issues raised by FGCIs are broadly similar to those raised by various types of privately-controlled investors or they can be subsumed under other issues that are covered in the section (e.g. foreign sovereign immunity, sabotage). For a discussion of financial policy issues see “Sovereign Wealth Funds and Pension Fund Issues” A. Blundell-Wignall, Yu-Wei Hu and Juan Yermo in Financial Market Trends, OECD 2008. The Committee on Fiscal Affairs is looking into whether or not the commentary on the Model Tax Convention should address the application of the principle of sovereign immunity to the income derived by SWFs. The paper International Tax Issues Related to Sovereign Wealth Funds looks at two issues: sovereign immunity and tax treaty entitlement of SWFs. See CTPA/CFA/WP1/MR(2008)1/CONF.

competition. Agencies in a number of other countries, such as Germany and Korea, [focus] on how conduct can be categorized.” Thus, competition policy authorities operate according to mandates embodying the same broad principles (protection of consumers and competition at the national level), but they differ in their implementation practices. Such differences are likely to influence national approaches to FGCl's.

24. Furthermore, when confronted with a question related to an investment proposal by a FGCI, recipient country competition authorities will want to know something about the home country policies affecting the FGCl's. For example: What is the FGCI’s policy purpose? What is the share of government ownership in the FGCI? If the entity is partially government-controlled, are its shares listed on a stock exchange? What organizational and financial arrangements govern the relationship between the FGCI and its home government? Although such investors may be structured to be as responsive to market forces as possible, it is unlikely that they will face exactly the same incentives as private actors. In the competition area, government-controlled investors, faced to some degree with competitive market pressures, but also responding to other mandates with the backing of their governments, cannot be expected to behave as privately-controlled actors would. Nor will other actors in product and financial markets treat them the same as private actors; this is for the following reasons:

- **Public service mission in the home country.** As noted above, many state-owned enterprises were created to fulfill some public purpose for the home society (e.g. to meet public service objectives). They therefore operate subject to constraints imposed by their home governments (e.g. production or employment targets, or universal service obligations). These home country constraints will inevitably influence decisions and behavior in global markets and, depending on the circumstances, this may have anti-competitive effects.

- **Product/service market disciplines.** Government-controlled investors may receive implicit or explicit subsidies from their home governments (e.g. preferential or monopolistic access to certain markets in the home country, direct subsidies). These are likely to affect the investor’s world-wide operations. Furthermore, government ownership can create transparency problems that may also become competition problems – for example, governments may be able to subsidize their SOEs through preferential pricing arrangements in public procurement contracts.

- **Financial market disciplines.** Financial market disciplines will also impinge differently on government-controlled investors. Take-over threats will be largely absent and, in cases of mixed public/private ownership, the disciplines coming from the market for private control will be

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13 For example, the mandate of the US Postal Service is as follows: The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities. The Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities and small towns were post offices are not self-sustaining. 39 U.S.C. 3622. Quoted in D. Sappington and J. Sidak, “Competition Law for State-Owned Enterprises”. 71 Antitrust Law Journal, No. 2 (2003). Page 499.

14 One study claims that SOEs with special service obligations can face strong incentives to engage in anti-competitive behaviours (e.g. to set prices below costs for predatory purposes, to misstatte costs, to raise the operating costs of existing rivals and to erect entry barriers to new competitors). “Incentives to act aggressively toward competitors can be created by government policy objectives that induce SOEs to value an expanded operating scale…. The enhanced valuation of increased revenue or expanded output leads the SOE to be less averse to higher costs associated with expanded output and revenue.” D. Sappington and J. Sidak, “Competition Law for State-Owned Enterprises”. 71 Antitrust Law Journal, No. 2 (2003). Page 480.
altered by the presence of the government shareholder. Furthermore, FGCLs government-controlled investors may benefit from the explicit or implicit backing of their home government for all or part of their operations (e.g. from credit or capital injections from other entities controlled by the home government), which will alter financial market disciplines. Finally, if subjected to financial stress, state-controlled investors may be subject to different pressures than private investors (due to increased susceptibility to political influence).

25. In order to avoid these affects on competition and market allocation, many countries have policies of keeping most of the business sector in private hands. Some countries have no long-standing tradition of extensive state ownership in the business sector (e.g. the United States). Others (e.g. much of continental Europe, Australia, Korea, Mexico, Turkey and the United Kingdom) have undertaken major privatisation efforts. A 2005 OECD survey\textsuperscript{15} notes that countries did this in order to give their economies a boost from the dynamism and efficiency of the private sector. These countries might be justified in thinking that acquisitions by foreign government-controlled investors do not sit well with their established policy positions regarding domestic government involvement in the economy.

Sabotage, espionage or impeding the implementation of host country policies

26. As noted in the introduction, discussions under the FOI project to date have failed to turn up a single case of a serious security problem being associated with such investments. Nevertheless, security-related concerns might be raised by such investments, especially when they affect physical or intangible assets that are considered, under the national security plan, to be “critical infrastructure.”

26. In past discussions held under the “Freedom for Investment” project, participants have identified risks that have been or should be factored into security-related investment policy analysis. The list of these risks appears below:\textsuperscript{17}

- Shutting down or sabotaging a critical facility;
- Unwillingness or inability to cooperate effectively in the protection of critical infrastructure;
- Impeding law enforcement (e.g. facilitating law-breaking by organised crime or by terrorist organisations) or national security investigations;
- Accessing sensitive data or becoming aware of investigations by national intelligence or law enforcement agencies;
- Limiting the host government’s access to information or moving data or records offshore;
- Denying critical technology or key products that are important for essential security instruments to the host government or moving them offshore;

\textsuperscript{15} This privatisation movement is documented in \textit{Corporate Governance of State Owned Enterprises: A Survey of OECD Countries}.

\textsuperscript{16} For a review of national critical infrastructure protection policies, see Critical Infrastructure Protection and the Role of Investment Policies Related to National Security (OECD, 2008). It can be accessed at the following address: \url{http://www.oecd.org/dataoecd/2/41/40700392.pdf}

\textsuperscript{17} Note that these are not only of relevance to the security-related risk assessment of investment proposals by foreign government-controlled investors, but may also be relevant for assessments of the suitability of private investors, both foreign and domestic.
• Unlawfully transferring technology abroad that is subject to export control laws;

• Undermining technological leadership in sectors important for safeguarding essential security interests;
Compromising the security of public or private networks with grave risks to public safety and public order;
Facilitating espionage or aiding the military or intelligence capabilities of a foreign country that is hostile to the recipient country.

27. The exact way that a foreign government investor might raise concerns relating to the above-mentioned risks depends on a number of factors:

- What is the nature of the political, diplomatic and economic ties between the recipient country and the home country of the FGCI?
- What is the FGCI’s reputation in the field concerned? Some government controlled investors have solid reputations in their fields of activity (e.g. water, electrical power, oil and gas production and distribution).
- How transparent is the FGCI? Does it provide sufficient information so that recipient country officials can perform the risk analysis needed to evaluate the proposed investment?
- How well designed are the investor’s management policies and practices (its governance, its risk management systems, its business partners, its other areas of activity)?

Foreign sovereign immunity and legal accountability

28. Under foreign sovereign immunity, one state is not subject to the jurisdiction of another state. This means that it is not subject to the full force of the rules of the other state. As a concept of law, sovereign immunity has a very long history and is strongly supported in national law and in treaties. It is a key basis for the smooth functioning of diplomacy.

29. For the investment policy community, however, foreign sovereign immunity raises questions and concerns and Roundtable participants expressed a strong interest in this area as a subject for future Roundtable discussions. One concern arises because the relevant laws vary among nations and they are changing over time. This variety and rapid change may contribute to a lack of clarity and predictability concerning the status of sovereign investors for the purposes of recipient country law enforcement. For the business partners of foreign government controlled investors and for the investors themselves, the lack of clarity about legal risks entails legal expenses to manage these risks. To the extent that sovereign immunity insulates sovereign investors from the full force of recipient country laws while depriving others of protections that would otherwise be due to them, it can create competitive disadvantages for private investors.

30. Investment policy may play a role in helping both home and recipient countries to address these concerns, while also assuring the smooth functioning of diplomatic processes. For example, the Australian Foreign Investment Review Board has required foreign government controlled investments “to be structured in such a manner that allows all normal taxes and charges to be levied and avoids questions of sovereign immunity arising…”18 During discussions at the 8th “Freedom of Investment” Roundtable, participants agreed that the issue of sovereign immunity and its possible implications for investment policy would merit further discussion at future Roundtables.

31. After reviewing recent legal developments regarding foreign sovereign immunity (in particular the trend toward introducing commercial exceptions to immunity) this section looks at two issues: 1) the status of foreign government-controlled investors under recipient country law enforcement; and 2) the status of legal protections for the business partners of these investors.

**Recent legal developments – a trend away from absolute immunity**

32. There are significant longstanding exceptions to the absolute immunity of foreign sovereigns: when the state itself initiates litigation, or when it consents to jurisdiction. And, in recent decades, a further restriction to sovereign immunity has appeared in some legal systems. These more recent restrictions constitute a legal trend, meant to favour regular law enforcement procedures. Generally speaking, the significance of this trend is to establish an exception to sovereign immunity, which applies when a foreign government is involved in “commercial activities” (or acts in the same way as a private person, in relations normally governed by what is termed “private law”). This exception makes it possible that a state can be compelled to live up to legitimate expectations, at least in its commercial dealings, and with respect to assets involved in its commercial dealings.

33. This trend is not uniform; it is important to note the diversity among states and applicable laws. Among states contributing to the trend, there is some variety in the precise approach; various formulations offer subtle differences. The Annex reproduces selected statutes or describes jurisprudence for Argentina, France, Germany, Italy, the United Kingdom and the United States. It also provides relevant excerpts from the United Nations Convention on Jurisdictional Immunities of States and their Property and the European Convention on State Immunity. Box 2 presents a list of 26 OECD and non-OECD countries that have contributed to this trend toward commercial restrictions for sovereign immunity by ratifying the United Nations or European Union Conventions or by codifying a commercial exception to sovereign immunity or through jurisprudence, and notes the impact of treaties and conventions. While some countries have legislation that excludes commercial activities from sovereign immunity, others (e.g. France, Germany and Italy) have no legislation and rely instead on international legal principles and jurisprudence.

34. In practice, diversity and complexity make the sovereign immunity area difficult. For example:

- **Immunity from enforcement.** In some legal systems, sovereign immunity can prevent enforcing an unfavourable judgement even after jurisdiction was allowed and a court or other dispute settlement forum took a decision. This demonstrates the full weight of the long tradition of sovereign immunity: there is resistance to allowing sovereign states to lose assets, presumably held for the public good, even if a court has decided that the case merits a remedy.

- **Emerging jurisprudence.** French jurisdiction clearly establishes that commercial assets do not benefit from sovereign immunity (see Annex). In contrast, while an Italian decision notes that a bond issuance by the government of Argentina was a private commercial activity not benefiting from sovereign immunity, the court nevertheless decided that the subsequent default on Argentina’s public debt, being motivated by the sovereign purpose of managing a serious economic crisis, did confer immunity from jurisdiction.
Box 2. National statutes and jurisprudence relating to foreign sovereign immunity

The following 26 countries listed below, including 18 OECD member countries, have participated in the legal trend toward restriction of sovereign immunity in regard to commercial activities or acts similar to that of a private person in relations governed by private law, by making changes to their statutes, ratifying a treaty, or by taking decisions in influential courts. In other words, each of these countries has initiated some type of "commercial activities" exception to automatic immunity, relevant to government-controlled investments:

Austria  France  Lebanon  Pakistan  South Africa
Belgium  Germany  Luxembourg  Portugal  Spain
Canada  Greece  The Netherlands  Romania  Sweden
Denmark  Italy  New Zealand  Senegal  Switzerland
Egypt  Islamic Republic of Iran  Norway  Singapore  UK

In specific subject matter, treaties can and have reinforced the trend by setting forth a commercial activities exception. And, more generally, the European Convention on State Immunity of 1972 – in force since 1976 – has established the exception for the eight countries that have ratified it, in identical terms. The effect is to set a common practice for their eight legal systems, thus clarifying the treatment of sovereign immunity in those territories, in a uniform manner.

Another kind of treaty has been developed, but the effort to bring it into force has not yet succeeded. The UN Convention on Jurisdictional Immunities of States and Their Property 2004 has been ratified by five countries: Austria, Iran, Norway, Portugal, and Romania. Thirty ratifications are needed for this treaty to come into force.

Foreign sovereign investors and recipient country law enforcement

35. Because of foreign sovereign immunity, foreign government controlled investors may not be subject to the full force of any legal system. As just suggested in the discussion of recent legal trends, where foreign government controlled investors stand in relation to legal accountability in a recipient country depends on the way that country handles commercial exceptions to foreign sovereign immunity. In cases of absolute sovereign immunity, a country faced with alleged wrong-doing by a foreign government investor would have diplomatic, but few legal, tools for dealing with the situation. It could, for example, expel the wrong-doer. However, in most cases, it would have to forego the usual procedures of law enforcement that would apply to other types of investor (including rights to information and procedures to determine responsibility or guilt or innocence).

36. Exempting commercial activities from foreign sovereign immunity means that most commercial issues and some other issues (for example business crime related to commercial activities) can be explored and resolved by recipient country courts. Thus, the commercial exception to sovereign probably contributes to allowing business with foreign-government controlled investors to take place in an orderly manner and, in terms of legal accountability, creates a more level playing field between these investors and

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19  Ratification of the European Convention on State Immunity (1972), or the UN Convention on Jurisdictional Immunities of States and Their Property (2004, not yet in force) or as identified as having significant jurisprudence or a statute in the following two sources: Ian Brownlie, Principles of Public International Law, Oxford University Press (2003) or Earnest K. Bankas The State Immunity Controversy in International Law, Springer Press (2005).

20  Generally speaking, the significance of multilateral accords – when they are very widely supported -- is that they are evidence of a strong intention that eventually can set a norm of international law. The effort at norm-building has not yet met great success with this instrument, as the UN Convention is not yet in force and few countries have ratified, and the Convention attracted negative publicity, particularly from Amnesty International, for items it omitted that have relevance to human rights.
private investors. However, the commercial activities exception does not completely eliminate concerns for recipient country law enforcement. For example, it remains true that while the commercial entity is normally subject to the full force of recipient country law, its home state still enjoys immunity; thus, if the home government instigates illegal activities via its commercial entity, it is still immune from recipient country enforcement actions.

Legal protections for the business partners of foreign sovereign investors

37. Foreign sovereign immunity can be the source of surprises, disappointments and expense for the business partners of foreign government-controlled investors. For example:

- If the sovereign immunity issue is not examined at the start of commercial dealings, then, although a government-controlled entity may in every way appear to be participating in a contract as a private party would, it may nevertheless have immunity that will prevent its being compelled to live up to its agreement. This affects the intrinsic value of their initial agreement – as one of the parties does not have legal protections normally due. It can be seen as an unfair competitive advantage for foreign government controlled investors.

- If the sovereign immunity issue is dealt with at the start of commercial dealings, the legal analysis can be complex, and expensive. The formulation in the law must be examined for each possible dispute settlement forum; any developments in this law must be monitored; and the diversity of legal formulations makes this analysis expensive. Indeed, the extent of sovereign immunity may not be knowable at the start of a commercial deal. Even the government-controlled investor possibly benefiting from immunity may not know with certainty. This is a transparency/predictability problem, from the point of view of market actors.

38. The commercial activities exception to sovereign immunity may help market actors be more confident of legal protections. Furthermore, codification and greater uniformity of sovereign immunity rules may enhance transparency and predictability. In circumstances where the extent of sovereign immunity is readily known, one may assume that markets will explore means to address remaining commercial risks assumed by private parties, and government investors can do likewise. For example, a contract negotiation could address this commercial risk—and a solution might be found, for example, in the pricing of a deal or a demand for a written consent to waive immunity.

IV. Recipient Country Policies vis-à-vis foreign government-controlled investors

39. Few OECD countries and non-member adherents to OECD investment instruments have formal restrictions targeted explicitly on investors that are owned or controlled by foreign governments. However, interest in this subject appears to be growing -- three countries (Australia, Canada and the United States) have recently clarified or strengthened their policies regarding this type of investor.

40. This section describes recipient country policies toward FGCIs using information provided earlier in the FOI project for a compilation of responses to a question on policy treatment of FGCIs and through notifications under the OECD investment instruments. These indicate that six countries (China, France, Greece, Japan, Netherlands, and Turkey) are of the view that such ownership is not relevant for investment policy. Korea’s response to the question indicates that it has “no regulation” in the area, which may be taken as an indication that practices toward foreign government-controlled investors do not differ from those for privately-controlled investors. In the case of Romania, there is no general discrimination.

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21 This section is an updated version of section IV of DAF/INV/WD(2006)13/REV1
but in the banking sector, preference is given to privatisation or to domestic or private individuals or legal persons, the latter majority privately owned.”

41. In late 2007, Canada issued guidelines under the Investment Canada Act (ICA) to clarify factors for assessment of “net benefit” that are set forth in the Act, as they may apply to concerns about investments by foreign SOEs. According to the guidelines, when assessing whether such acquisitions are of net benefit to Canada, the Ministry responsible for administering the ICA “will examine, as part of the assessment of factors enumerated in the Act the corporate governance and reporting structure of the non-Canadian. This examination will include whether the non-Canadian adheres to Canadian standards of corporate governance (including for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders) and to Canadian laws and practices. The examination will also cover how and the extent to which the non-Canadian is owned and controlled by a state.”

42. The United Kingdom, while noting that the ownership of the bidder makes no difference in the way the bid is considered, states that “government ownership might affect the UK’s assessment of whether or not the bid raised public interest concerns.” In particular, it could trigger concerns about whether the investor is influenced to “behave in a non-commercial manner in pursuit of political objectives”. Similarly, Germany states that “the ownership of the foreign investment company (state or private) and its strategic interests will be taken into consideration.”

43. Australia indicated that foreign government controlled investors are examined in the same way as proposed investments by private investors, but noted that its “screening regime applies to all proposed direct investment by foreign government controlled companies” – that is, it is not subject to the size threshold that apply to other investments. In February 2008, Australia issued “Principles Guiding Consideration of Foreign Government Related Investment in Australia” in order to enhance the transparency of its review procedure vis-à-vis this category of investor.

44. The United States evaluates “foreign government control” on a case-by-case basis and mandates the Committee on Foreign Investment in the United States to perform a second-stage national security investigation of bids by state-owned companies and formalizes the role of the national intelligence director in such reviews.

45. Four adherents to the OECD investment instruments have lodged reservations to the Code of Liberalisation of Capital Movements and/or notified National Treatment exceptions for their policies regarding foreign government-controlled investors. Iceland prohibits “investments by foreign states or state-owned enterprises unless an authorisation is granted” (both the Code and the National Treatment Instrument). Mexico limits direct investment by foreign governments and state-owned enterprises in a number of specific activities (the Code); Spain reserves a right to restrict “investment originating” in non-EC member countries by governments, official institutions and public enterprises” (the Code) and Australia maintains a Code reservation regarding “investments by foreign governments and their agencies”.

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23 These Principles can be found at: http://www.treasurer.gov.au/
V. Treatment under the OECD instruments and in international investment agreements

46. OECD surveys suggest that government-controlled investors often benefit from the protections afforded by international investment agreements. A recent OECD survey\(^\text{25}\) states the following (the texts below are direct quotes from the OECD survey):

- **International Centre for the Settlement of Investment Disputes**: The ICSID definition is not explicit as to whether eligibility is limited to investors who are private entities or whether they could be state-controlled.\(^\text{26}\) ICSID was confronted with this question of the access to the Centre of an investor with legal personality but controlled by a state in the case **CSOB v. Slovak Republic**\(^\text{27}\) (the state retained 65% of the capital). The tribunal noted that the term “investor” in the Convention, did not exclusively concern the companies with private capital but also companies partially or entirely controlled by a state.\(^\text{28}\) It therefore decided that a legal person could have access as an investor to proceedings under ICSID unless it acts as a state agent or undertakes a governmental function.\(^\text{29}\)

- **International investment agreements**. Some investment agreements make it clear that state entities are included. For instance, the **2004 US Model BIT** and **Canada Model FIPA** cover governmentally owned or controlled entities. According to Article 1, Definitions, “enterprise” means any entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled... ” [emphasis added]. Some investment agreements include in addition to state entities, the government itself. For instance, in the 1996 **Czech Republic-Kuwait BIT** and in the 2001 **Belgium-Saudi Arabia BIT**, the Government qualifies as an investor.\(^\text{30}\)

- **MIGA Convention**. Similarly, article 13(a)(iii) of the **Convention establishing the Multilateral Investment Agency**, defines eligible investors to include a juridical person “whether or not is privately owned...” [emphasis added].


\(^{26}\) On this issue, see the discussion by S. Manciaux *Investissements étrangers et arbitrage entre États et ressortissants d’autres États : Trente années d’activité du CIRDI* (Travaux du Centre de recherche sur le droits des marchés et des investissements internationaux, Paris, Litec 2004).

\(^{27}\) *Ceskoslovenska Ochodni Banka (CSOB) v. Slovak Republic*, ICSID case ARB/97/4, Decision on Jurisdiction, 24 May 1999.

\(^{28}\) *CSOB v. Slovak Republic*, para. 16.

\(^{29}\) *Idem* paras. 17, 20-25.

\(^{30}\) A number of governments expressed some concern about the insistence of their counterparts in BIT negotiations to include the Government itself as an investor, in particular with respect to national security issues.
47. In describing the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations, the 2007 Users’ Guide for the Codes states that government owned enterprises are covered by the principles set forth in the Codes. Page 22 of the Guide states: “Government-owned industrial, commercial or financial enterprises are treated like private enterprises” under the Codes. …. Where government-owned enterprises act, for instance, as service suppliers, host countries should accord them the same rights to provide cross-border services as are enjoyed by private enterprises.” Thus, under this interpretation, the Codes set forth principles for recipient country policies that are relevant for foreign government-controlled investors.
## ANNEX

### FOREIGN SOVEREIGN IMMUNITY – SELECTED NATIONAL AND INTERNATIONAL LEGAL PRINCIPLES

<table>
<thead>
<tr>
<th>Country</th>
<th>Legal Text</th>
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<tbody>
<tr>
<td><strong>Argentina</strong></td>
<td>Law 24488 of May 31, 1995 (unofficial translation)</td>
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<tr>
<td><strong>France</strong></td>
<td>There are no legal texts dealing with foreign sovereign immunity under French law. However, the French <em>Cour de cassation</em> has drawn a distinction between state assets that were allocated to a sovereign or public activity and state-owned commercial assets. Whilst sovereign immunity would protect the former category, it does not apply to the latter. Only assets that were shown to be commercial or related to the commercial activity that gave rise to the dispute, escaped immunity.</td>
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<tr>
<td><strong>Germany</strong></td>
<td>No codified law.</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td>No codified law, but jurisprudence exists. In particular, the decision – Cassazione civile, SS.UU., ordinanza 27.05.2005 n° 6532 – notes that a bond issuance by the government of Argentina was a private commercial activity benefiting from sovereign immunity. However, the subsequent default on Argentina's public debt obligations, being motivated by the sovereign purpose of managing a serious economic crisis, did confer immunity from jurisdiction. Thus, the court decided that it had no jurisdiction in the case.</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
<td>The UK State Immunity Act (1978) 3. (1) A State is not immune as respects proceedings relating to -- (a) a commercial transaction entered into by the State; or (b) an obligation of the State which by virtue of contract (whether a commercial transaction or not) fall to be performed wholly or partly in the United Kingdom. .... In this section, ‘commercial transaction’ means -- (a) any contract for the supply of goods or services; (b) any loan or transaction for the provision of finance and any guarantee or indemnity in respect of such transaction or of any other financial obligation; and (c) any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a State enters or in which it engages otherwise than in the exercise of sovereign authority.</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td>The Foreign Sovereign Immunities Act (FSIA) of 1976 § 1605. General exceptions to the jurisdictional immunity of a foreign state (a) A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case— (1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver; (2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in</td>
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connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States;

|---|
| **Article 10**  
**Commercial transactions**  
1. If a State engages in a commercial transaction with a foreign natural or juridical person and, by virtue of the applicable rules of private international law, differences relating to the commercial transaction fall within the jurisdiction of a court of another State, the State cannot invoke immunity from that jurisdiction in a proceeding arising out of that commercial transaction.  
2. Paragraph 1 does not apply:  
(a) in the case of a commercial transaction between States; or  
(b) if the parties to the commercial transaction have expressly agreed otherwise.  
3. Where a State enterprise or other entity established by a State which has an independent legal personality and is capable of:  
(a) suing or being sued; and  
(b) acquiring, owning or possessing and disposing of property, including property which that State has authorized it to operate or manage, is involved in a proceeding which relates to a commercial transaction in which that entity is engaged, the immunity from jurisdiction enjoyed by that State shall not be affected.  

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<tr>
<th>European Convention on State Immunity (1972)</th>
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| **Article 6.** A contracting state cannot claim immunity from the jurisdiction of the court of another Contracting State if it participates with one or more private persons in a company, association or other legal entity having its seat, registered office or principal place of business on the territory of the State of the forum and the proceedings concern the relationship, in matters arising out of that participation, between the State on the one hand and the entity or any other participant on the other hand. ...  
**Article 7.** A Contracting State cannot claim immunity from the jurisdiction of a court of another Contracting State if it has on the territory of the State of the forum an office, agency or other establishment through which it engages, in the same manner as a private person, in an industrial, commercial or financial activity and the proceedings relate to that activity of the office, agency or establishment.  

The Annex commentary on Article 17 states that “The expression “commercial transaction” includes investment matters.”