**OECD ROUNDTABLE ON FREEDOM OF INVESTMENT,
NATIONAL SECURITY AND "STRATEGIC" INDUSTRIES**

PARIS, FRANCE - 6 DECEMBER 2006

Summary of the Discussions

The participants included delegates from OECD member and other countries adhering to the Declaration on International Investment and Multinational Enterprises. The governments of some other non-OECD countries were also represented, including China, Egypt, Malaysia, Russia and South Africa. A small number of private sector experts on international investment included Pascal Dupeyrat, Relians Consulting; Richard O'Toole, Goldman Sachs; and Wang Wei, China Mergers and Acquisitions Association. OECD policy communities other than the Investment Committee also participated, including the OECD Competition Committee and the Steering Group on Corporate Governance, both represented by their secretariats.

The discussions were organised in two main blocks. First, a Tour de Table was organised during which a small number of Committee delegates (Australia, Japan and United Kingdom) made presentations of their national frameworks for addressing security and other essential concerns, and private sector participants told participants how national frameworks are seen from the investors' perspective. Second, a number of topics identified as of particular interest were discussed in depth, including the role of national security in international investment agreements; regulations (other than the ones motivated by investment policy) and private sector approaches bearing on cross-border takeovers; and the regulatory treatment of state-controlled enterprises. This document by the OECD Secretariat summarises findings from the discussions so far.

Concerns about security and other essential national interests are on the rise. In recent years rapidly growing international direct investment in the form of cross-border mergers and acquisitions has given rise to concerns for policy makers in OECD countries and beyond. Several participants observed that, while countries generally welcome foreign investment, the acquisition of well-known national enterprises is often a source of political controversy. The pressures have been heightened by concerns about the tighter international security environment, by the emergence of outward investors from countries that many consider operate by standards of corporate behaviour and openness to foreign investment that are lower than in OECD countries, as well as control over access to energy and scarce raw materials.

Stock takings by the Secretariat indicate that a small number of OECD countries have already strengthened their investment policy frameworks for dealing with security concerns, or are in the process of considering such steps. France and Germany have both introduced "negative lists" of sectors and activities which restrict access for foreign investors. In the United States, Congress is considering tightening the procedures of the Committee on Foreign Investment (CFIUS) under Exon-Florio security legislation. Canada is thinking of introducing security provisions in investment legislation. Outside the OECD area, Russia is in the process of establishing for the first time an explicit framework for addressing national security concerns in investment policy, and China has just introduced a new screening requirement on mergers and acquisitions by foreign investors in "major" industries having an impact on "national economic security".

The cost of getting it wrong is substantial. While governments have a responsibility to safeguard essential security interests, there is a risk that they might yield to protectionist pressures and tighten investment regulation with measures that go beyond what is necessary to address legitimate security concerns. Furthermore, other countries, seeing such defensive measures, may interpret them as protectionist and begin to tighten their own investment regimes. Private sector participants at the Roundtable opined that an increased number of investment projects encounter resistance in OECD and non-member countries for reasons of security and other "strategic" interests. The price of such investment protectionism, if borne out by the facts, will be slower growth.

Corporate takeovers appear to be the primary focus of recent regulatory developments. It is sometimes believed that the economic cost of restrictions in the case of mergers and acquisitions is smaller than for restrictions of other forms of foreign direct investment. Recent OECD surveys of empirical evidence shows that the benefits to a host country from foreign takeovers do not differ much from those of greenfield investment and therefore the economic justification for discriminating between "new" investment and acquisitions of existing enterprises is weak. Second, there is evidence of cross-border takeovers having a positive effect on the targeted enterprise. The main direct economic benefits are higher efficiency and, concomitantly, higher wages in foreign-owned enterprises. Third, the economy-wide benefits from foreign investment are also well-documented, but depend in no small measure on the policies and institutional environment in the host country, especially to deal with dislocation and loss of employment. In consequence, political resistance to foreign investment can in many cases be tracked back to a reluctance to undertake necessary structural reform.

Regulatory national practices vary, but common principles exist among OECD countries. Participants at the Roundtable discussed a preliminary inventory of practices among OECD and non-member adherents to the OECD investment instruments conducted by the Investment Committee, which suggests the following findings:

- *National security concerns play a role in most countries' investment policies, but few of them clarify or attempt to define what they mean by "security".* A majority of countries maintain specific sectoral restrictions on security grounds, half of which are limited to the production or handling of defence materials. The few countries that rely on some form of general screening of investment deal with security issues largely on a case-by-case basis.
- *Perceptions of essential interests other than national security vary across countries.* Taking countries' exceptions to the OECD National Treatment instrument as an indication, most perceptions of essential interests other than security are of a somewhat "defensive" nature. Rather than focusing on strategic sectors and national champions, a large number of exceptions appear to be motivated by the defence of traditional livelihoods.
- *Avoiding overregulation is a concern.* Many investment authorities report to defer as much as possible to specialised regulatory agencies for remedies before invoking their own powers. An example of such remedies is merger regulation where parties to a major merger in most countries must notify the competition agency in advance and wait until the end of the review process before closing the transaction. Another relates to the takeover of listed companies where investment authorities may choose to await the outcomes of reviews by stock exchanges and securities regulators. Representatives of the competition policy and corporate governance communities at the OECD provided the Roundtable with an overview of such practices and

cautioned that they may sometimes be used to throw up informal barriers to cross-border takeovers.

- *Few adhering countries practice statutory discrimination against enterprises controlled by foreign governments*. Conversely, relatively many investment authorities – particularly those involved in screening of investment – apply, or have the option of applying, stricter scrutiny in case of foreign public control. This concern appears to have been heightened in recent years.

- *Safeguarding the integrity of procedures should be an overriding priority.* OECD countries consider that they observe high standards in this respect. Yet, national approaches differ, as do views of best practices. This topic was identified by participants as a priority area for further discussions at future Roundtables. Some of the main aspects are:

  – Countries agree that strict confidentiality must be maintained. This includes protecting not only sensitive business information but also the knowledge that an application for approval has been filed. Countries have safeguards in place to prevent such information from reaching corporate competitors, although the degree to which information may be shared with other branches of the public sector vary.

  – There is also broad agreement that regulatory action must be proportional: in the sense that it affects only the aspects of the proposed transaction or corporate behaviour that are seen as being a threat to security; and, proportional in the sense that the regulatory impact can be justified by the scale of the threat and the hoped-for benefits of the action taken.

  – National practices differ with regard to transparency and predictability. Countries with "negative lists" of sectors in which foreign investment is subject to authorisation or prohibition would claim to be more transparent because they announce their sensitivities in advance. Countries with a case-by-case screening approach may emphasise "predictability" of their procedures, arguing that full transparency involves a degree of information disclosure of information that is neither in the corporate nor the regulatory interest.

  – Countries also differ in respect of the access to appeal. Some allow rejected investors to challenge the final awards in the courts or administrative tribunals. Others allow investors to challenge procedural aspects, but not awards, before administrative tribunals. Still others have no appeals mechanisms. The latter mostly allow for a procedure of consultations and revisions of proposals in the early phases of their authorisation procedures.

Informal barriers may be as important as statutory ones. Private sector participants observed that many of the widely quoted examples of apparent investment protectionism by national authorities have been *ad hoc* and not backed up by formal investment regulation. For instance:

- As concerns about the effects of globalisation have moved up on the political agendas in many countries, elected officials have increasingly made statements about whether foreign takeovers of national enterprises are "welcome" – or not. Even where legislatures have no direct responsibility for investment regulation, the prospect of having to operate amid the hostility of the national authorities would be sufficient to deter many investors.

- Regulatory approaches not formally related to investment policy have allegedly been employed to protect 'strategic' enterprises. Investors have claimed that anti-trust regulation, financial supervision, subsidisation of corporate alternatives, ad hoc legislative changes as well as the burden and lengthiness of a host of administrative procedures have been used to impede cross-border takeovers.

- Private sector takeover devices (e.g. poison pills; cross-held or cascading shareholdings; white knights) and other anti-competitive practices may be used to selectively discourage cross-border transactions. Other devices with a degree of government involvement that militate against foreign ownership include the role of public-owned banks, the use of golden shares in privatised enterprises and compulsory employee representation on corporate boards. Representatives of the EU Commission made a presentation of European experiences with such measures, including the degree to which they might interfere with freedom of establishment. Insofar as governments have it in their power to prevent arrangements used to discriminate against foreign investors but abstain from doing so, these arrangements could fall under the purview of the disciplines of the OECD's investment instruments.

International investment agreements do not provide for unqualified security exceptions. Most countries are parties to bilateral investment treaties, trade agreements with investment content or OECD's investment instruments, under which they have undertaken to grant market access and national treatment to foreign investors (in some or all sectors). However, such agreements generally recognise the right of the parties to take non-conforming measures to protect essential security interests. A recent OECD survey of international investment agreements shows that the scope of this right has defined limitations under customary international law. Treaty provisions stating the security exception are most often expressly limited, with the covered security interests precisely defined and circumscribed. OECD instruments like the Code of Liberalisation of Capital Movements contain language allowing host governments to self-judge their security needs but have safeguards such as notification, periodic review and consultative mechanisms to prevent abuse of their security clauses to escape the instruments' disciplines.

Next steps. The next Roundtable will take place in March 2007. The topics for consideration will include the identification of ultimate beneficial owners and their nationality; and main procedural considerations for investment regulators.