FDI Protectionism Is on the Rise

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Abstract

Over the past two decades or so, countries have liberalized their FDI regulatory frameworks and have put in place an international investment law regime that provides various protections for international investors. In the past few years, however, there are signs that countries are reevaluating their approach toward such investment. As a result, FDI protectionism is on the rise, with screening of inward M&As becoming more frequent. Typically, this is being done under the guise of "national interest" or similar concepts, often linked to strategic sectors and national champions. While the international investment law regime faces a challenge to find the right balance between the rights and responsibilities of governments and investors, care needs to be taken that the rise of FDI protectionism does not endanger a rules-based approach to FDI. An independent FDI Protectionism Observatory to monitor new protectionist measures and name and shame countries that take them is therefore needed.
FDI protectionism is on the rise

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The Rise of FDI and the nature of the international investment regime

Foreign direct investment (FDI) is the most important vehicle to bring goods and services to foreign markets. World annual FDI inflows rose from an average of $50 billion during 1981-1985 to $1.9 trillion in 2007 (figure 1); in the case of a number of emerging markets, a good part of outward FDI is being undertaken by state-owned entities (which, as will be discussed below, are subject to particular scrutiny in a number of countries). By the end of 2007, world FDI flows had accumulated to a stock of $15 trillion, controlled by over 80,000 multinational enterprises (MNEs) that have more than 800,000 foreign affiliates. World FDI flows declined in 2008 by 15 percent as a result of the financial crisis and recession; they will decline further in 2009, perhaps by as much as 50 percent. Even with this decline, however, the level of FDI flows is significantly above that of the 1980s and the stock of this investment keeps growing: as long as flows are positive, the stock of FDI—and hence the importance of international production—increases.

Figure 1. FDI inflows, global and by group of economies, 1980-2008 (US$ billion)


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1 Unless otherwise indicated, the data in this section are from UNCTAD, World Investment Report (Geneva: UNCTAD, 2008) or the Organization’s IIA database.

2 In the case of China – the biggest outward investor among emerging markets – state-owned enterprises accounted for 83% of OFDI flows in 2005; by the end of 2005, their share of OFDI stock was 84%. (See Leonard K. Cheng and Zihui Ma, “China’s outward FDI: past and future” (July 2007), p. 15 online: http://www.nber.org/books_in_progress/china07/cwt07/cheng.pdf. (These figures do not include FDI by state-owned enterprises administered by regional governments.) The Government of China, through its “Going Global” policy, is actively supporting OFDI from China. Like their competitors from other countries, Chinese firms rely more and more on mergers and acquisitions when entering foreign markets, as opposed to greenfield investment.

The total sales of foreign affiliates amounted to $31 trillion in 2007, which compares with world exports of $17 trillion the same year. In addition, the emergence of international production networks established by MNEs helps to integrate national production systems; this is not only reflected in the ownership and control ties that are established, but also in the fact that about one-third of world trade consists of intra-firm trade, i.e., trade among the various units of the same corporate systems located in different countries. All this makes FDI an important source of capital, technology, know-how, and access to markets – all tangible and intangible assets that are central to economic growth and development. And this importance of FDI underlines the significance of an appropriate regulatory regime governing this investment.

The rise of FDI was made possible, to a large extent, by an enabling regulatory environment. Especially since the mid-1980s, the investment climate has become more welcoming for foreign direct investors. Countries have liberalized national entry conditions for MNEs, instituted various measures to attract such enterprises actively (e.g., through incentives and the establishment of investment promotion agencies) and facilitated the operations of foreign affiliates once established (table 1).

Table 1. National regulatory changes, 1992-2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of countries that introduced change</th>
<th>Number of regulatory changes</th>
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<tbody>
<tr>
<td>1992</td>
<td>43</td>
<td>77</td>
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<tr>
<td>1993</td>
<td>56</td>
<td>100</td>
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<td>270</td>
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<td>2005</td>
<td>92</td>
<td>203</td>
</tr>
<tr>
<td>2006</td>
<td>91</td>
<td>177</td>
</tr>
</tbody>
</table>


These national regulatory changes have been complemented by international investment agreements (IIAs), particularly bilateral investment agreements (BITs), enshrining (among other things) the non-discriminatory protection of investment (figure 2). Increasingly, moreover, commitments for the protection of international investment, and indeed the liberalization of entry conditions, are also included in free trade agreements; in fact, the great majority of modern free trade agreements are also free investment agreements (figure 3). As a result, and even in the absence of an overarching multilateral investment treaty, a relatively strong international investment regime has emerged, at least as far as the protection of investors is concerned. It is enforced, moreover, through

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4 Independent of the changes that countries have made regarding FDI, countries have also improved – and are continuing to do so – the business climate for investment in general (some of these changes may also be captured by the UNCTAD data). Thus, the World Bank observed (Doing Business 2009 (Washington: The World Bank, 2008), p. 1) “Worldwide, 113 economies implemented 239 reforms making it easier to do business between June 2007 and June 2008. That is the most reforms recorded in a single year since the Doing Business project started. In the past year reformers focused on easing business start-up, lightening the tax burden, simplifying import and export regulation and improving credit information systems.”

5 There are, however, several multilateral treaties that cover aspects of international investment, most notably the GATS and TRIMs agreements of the WTO, as well as MIGA.

6 There are, however, a number of limitations to this regime. Among others, some limitations are related to the fact that there is no overarching multilateral framework governing foreign investment (as the regime
an investor-state dispute settlement mechanism that is increasingly used by firms to protect what they see to be their rights: there were a minimum of 318 known treaty-based international investor-State disputes by the end of 2008, with 30% of them brought by investors during 2006-2008 (figure 4). For comparison: 91 panel reports were issued under Article XXIII of the GATT between 1948 and 1994, and 161 panels were established by the Dispute Settlement Body under the WTO between the beginning of 1995 and November 24, 2008.

Figure 2. Growth of bilateral investment treaties, 1959-2008, by period and cumulative

Source: UNCTAD, www.unctad.org/iia


7 Only ICSID reports the number of cases; hence the actual number of disputes is likely to be higher. The following data are from UNCTAD, “Latest developments in investor-State dispute settlement,” IIA Monitor No. 1 (2009), UNCTAD/WEB/DIAE/IIA/2009/6, available at: http://www.unctad.org/en/docs/webdiaeia20096_en.pdf. (UNCTAD has the most comprehensive database on international investment disputes.) For a discussion of the reasons for this explosion of investment disputes, see Jeswald W. Salacuse, “Explaining the increased recourse to treaty-based investment dispute settlement,” in Appeals Mechanism, op. cit., pp. 105–126.

8 It should be noted, however that disputes in the framework of the GATT/WTO multilateral trading system are State-State disputes.
Figure 3. Number of international investment agreements other than bilateral investment treaties and double taxation treaties concluded, cumulative and per period, end 2008


Figure 4. Known investment treaty arbitrations, cumulative and newly instituted cases, 1989–2008

The rise of FDI protectionism

There is no doubt that countries continue to improve the regulatory framework for FDI. If anything, the current crisis should put a premium on attracting more of such investment, be it to shore up ailing national firms or, more generally, increase investment at a time of recession. Indeed, as reports by the OECD and UNCTAD show, this is taking place. Thus, the OECD reports that the “thrust of investment policy changes is, for the most part, toward greater openness and clarity… During the reporting period, six countries changed the laws governing their investment policies. Although the intended thrust of the policies is somewhat ambiguous, most of the changes aimed (according to announcements or notifications by governments) at increasing openness and clarity for investors.”

Similarly, UNCTAD reports, “a substantial number of policy changes surveyed were directed at facilitating investment. The crisis has galvanized G-20 members to promote and facilitate FDI and to create clarity and stability concerning their investment frameworks. Furthermore, a number of G-20 member countries have further encouraged their companies to venture abroad, and to support their foreign affiliates in times of economic crisis.”

At the same time, however, there are strong and visible signs that a re-evaluation of the open framework for FDI is under way, and this is reflected in the national and international rules governing this investment.

This change is most distinct so far at the national level. During the period 1992-2002, 6 percent of a total of 1,550 regulatory changes relating to FDI were in the direction of making the investment climate less welcoming (i.e., 94 percent of the regulatory changes were favorable to MNEs – table 1). The share of unfavorable changes doubled to 12 percent of all regulatory changes during 2003-2004, and again almost doubled to 21 percent of all regulatory changes during 2005-2007. In the case of Latin America, some 60 percent of all FDI regulatory changes in 2007 were unfavorable to foreign investors (figure 5). Moreover, these data refer to formal changes in laws and regulations; no data are available on the extent to which unchanged laws and regulations are implemented in a more restrictive manner, increasing informal barriers to the entry and operations of foreign investors in a discriminatory manner.

Overall, countries that had implemented at least one regulatory change that made the investment framework less welcoming during 2006-2007 accounted for some 40 percent

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of world FDI flows—an impressive figure that demonstrates quite convincingly that a change is underway.

![Figure 5. National FDI policy changes, by region, 2007](image)


While it is clear that something is happening, not every measure that makes the investment climate less welcoming for foreign direct investors is protectionist. Basically, there are two situations that qualify as FDI protectionism: in the context of inward FDI, FDI protectionism involves new measures by public authorities that are taken to prevent or discourage foreign direct investors from investing in, or staying in, a host country. In the context of outward FDI, FDI protectionism involves measures directed at domestic companies that require them to repatriate assets or operations to the home country or discourage certain types of new investments abroad. In fact, the situation is more complicated because, for instance, measures taken in the interest of legitimate public policy objectives – e.g., protecting national security, seeking to increase the contribution of FDI to the host or home economy – are not necessarily instances of FDI protectionism, even if they make the investment climate less hospitable for foreign investors.

Even with this caveat, it is clear that the regulatory framework is becoming more restrictive. It predates the current financial crisis and recession, suggesting that a reevaluation of the costs and benefits of FDI had already been underway. The financial crisis and recession may dampen the rise of FDI protectionism as countries seek capital to

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shore up local firms and to increase investment to help them emerge from the recession. But the crisis may also accentuate protectionism, especially if nationalistic impulses gain the upper hand, perhaps stimulated by fire-sales of domestic assets (as we saw during the Asian financial crisis\(^{14}\)).

The principal approach that has been taken to make the regulatory framework more restrictive for foreign investors is to evoke “national interests,” “essential security interests” or similar concepts (often linked to strategic sectors and national champions), to screen foreign investments at the national level. These concepts are typically not defined precisely, thereby giving governments of host countries discretion to limit the applicability of the regulatory framework and opening potentially the door for discriminatory treatment of foreign investors. This approach also focuses on cross-border mergers and acquisitions (M&As)\(^{15}\) and pays particular attention to sovereign FDI (i.e., FDI undertaken by sovereign wealth funds and state-owned enterprises).

The measures taken by the US are illustrative. On the one hand, the US remains one of the most open countries for FDI, as underlined, for example, in the May 2007 statement on “Open economies” by former President George W. Bush\(^ {16}\) and the establishment of an “Invest in America” office in the Department of Commerce.

At the same time, though, and especially in the aftermath of 9/11, national security concerns have risen in prominence.\(^ {17}\) For the US, this concept involves primarily (but not only) military security, namely the protection of the defense industrial base and critical technologies that provide a military advantage, as well as more broadly the protection of assets that constitute critical infrastructure\(^ {18}\) (the damage to which could harm the


\(^{15}\) M&As account for the bulk of FDI in developed countries and a substantial share of FDI in emerging markets. A 2007 Economist Intelligence Unit survey of 258 senior executives across Asia found that the US (24 percent), China (23 percent) and France (13 percent) are regarded as the countries most likely to block M&As because of strategic or political considerations. See Norton Rose, *Cross-border M&A: the Asian Perspective* (London: EIU and Norton Rose, 2007), p. 4. It would however be wrong to conclude from these data that M&As are typically resisted: the bulk are normal commercial transactions that receive little attention (unless competition issues are involved).


\(^{17}\) To quote the then U.S. Secretary of the Treasury, Henry M. Paulson: “Foreign investment into the United States, especially by sovereign wealth funds and state-owned enterprises, is also increasingly viewed with suspicion by some U.S. companies, various members of the national security community, and the American public at large….” See his “A strategic economic engagement: strengthening U.S.-Chinese ties,” *Foreign Affairs*, vol. 87 (September-October 2008), p. 72.

\(^{18}\) “Critical infrastructure” is described as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity and destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.” In the context of investment, the description refers to “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on national security.” See Department of Homeland Security, “National infrastructure protection plan” (Washington: Department of Homeland Security, 2006), at www.dhs.gov. According to Edward M. Graham and David M. Marchick (*US National Security and Foreign Direct Investment: A Strategic Approach* (Washington: Center for Strategic and International Studies, 2008), p. 124.)
nation’s security). It also includes protection against terrorism concerns and cooperation on important geo-strategic security initiatives, such as nonproliferation. To clarify the Government’s authority and the process undertaken to ensure that cross-border M&As do not infringe on national security, the United States in 2007 passed the Foreign Investment and National Security Act (FINSA), which codified the role of the Committee on Foreign Investment in the United States (CFIUS) in reviewing the national security implications of cross-border M&As. CFIUS has the authority to review and investigate cross-border M&As and to negotiate, impose and enforce conditions to mitigate any threat to national security presented by any transaction. If a review takes place, it must be completed within 30 days. If such a review leads to an investigation, it needs to be completed within 45 days. A transaction is to be investigated if any of the following conditions applies: a transaction threatens to impair the national security of the U.S, and this threat has not been mitigated during or prior to the review of the transaction; a transaction involves a foreign government-controlled entity; a transaction would result in control of any critical infrastructure and could impair national security; or the lead agency and CFIUS agree that an investigation should take place. If CFIUS recommends action, the President must make a decision within 15 days. As can be seen from these criteria, there is a presumption that any M&A by a foreign sovereign investor (be it a state-owned enterprise or a sovereign wealth fund) reviewed by CFIUS needs to be investigated (unless it is determined at the stage of the review that no national security concerns arise).

Not surprisingly, the number of notifications to CFIUS and the number of investigations rose from, respectively, 55 and 1 in 2001 to 165 and 22 in 2008 (figure 6). (Data for the first six months of 2009, however, show a decline of notifications to 36 – which is a pace for 60-70 this year, down from 165 last year; this indicates perhaps the recognition that the country needs, at least in the current economic situation, direct investment from abroad, including from sovereign investors.) It is not known how many cross-border M&As that were intended or initiated did not go forward because of the new US regulatory framework.

Other developed countries, too, have put in place mechanisms that allow stricter screening, with concerns regarding national interests often being also of an economic nature. In Europe, both at the national level and at the level of the European Commission, they involve, in particular, sovereign FDI from Russia (and, perhaps in the near future, from China) and, more broadly, the protection of national champions. Specific national policy responses include:

- **Germany**: A recent amendment to the Foreign Trade and Payments Act established a CFIUS-type review mechanism to protect German firms from certain foreign takeovers.

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19 US regulatory changes do not extend to greenfield investments.


21 U.S. Treasury Department.
Acquisitions by non-EU and non-EFTA firms of 25% or more of a German company’s voting rights will be reviewed by the Government if they threaten “public security” or “public order.” This amendment entered into force on April 24, 2009. As in the case of the US, foreign investors can voluntarily pre-notify the Government before an intended acquisition to obtain legal certainty.

Figure 6. CFIUS filings and investigations, 2001-2008

![Graph showing CFIUS filings and investigations, 2001-2008](Image)

Source: US Treasury Department.

- **France**: A decree was issued at the end of 2005 identifying 11 strategic sectors in which investment proposals fall under the purview of the review authorities. In 2008, action was taken to earmark 20 billion Euros for a new state investment fund, among other things, to protect France’s strategic industrial assets from foreign takeovers.
- **Australia**: Under the *Foreign Acquisitions and Takeovers Act of 1975*, the Government must determine whether proposed foreign acquisitions are consistent with Australia’s national interest (not defined). A new policy was announced on February 17, 2008 for proposed investments by sovereign investors. It requires that reviews of applications by such investors consider six specific issues, including whether an investor’s operations are independent from the relevant foreign government; the investor’s observance of standards of business behavior; the investment’s impact on


Australia's national security; and the contribution of an investment to the country’s economy and community.  

- **Canada:** On March 12, 2009, Canada amended its foreign investment law. Apart from changes that liberalized the country’s foreign investment review process of general application, the amendment also included a national security test for proposed investments in Canada, which applies to a much broader range of proposed transactions than the pre-existing “net benefit” test. Now, a proposed investment may be subject to national security review even if it does not exceed the threshold for the net benefit review, whether the investment is proposed or already implemented, and even in cases in which a minority interest is acquired in a Canadian business (i.e., where there is no acquisition of control of a Canadian target). As in the case of other countries, there is no definition of what could be “injurious to national security,” and there is a distinct possibility that the test could be used to target certain types of sovereign investment. The details of the national security review process were outlined in draft regulations published on July 11, 2009.

- **Japan:** According to its Foreign Exchange and Foreign Trade Act, foreign investments that potentially impair national security (not defined), disturb the maintenance of public order, hinder the protection of public safety, or have significant adverse effect on the “smooth management of the Japanese economy” must be screened by the Ministry of Finance and the Ministry “having jurisdiction over the business.” The Act was strengthened in 2007 through a regulation that requires foreign investors to notify the Government 30 days in advance if they planned to acquire 10 percent or more of listed companies with technology that can be used in weapons systems.

Additionally, in response to the global financial crisis and recession, several developed countries introduced emergency measures, among other things, to bolster the stability of their financial services sectors and to increase the availability of credit to other parts of their economies. A recent survey of these measures found “early evidence of differentiation between foreign and domestic actors” in these emergency plans. For instance, the authors of the survey noted that, under the U.S. Emergency Economic Stabilization Act, domestic institutions are “the majority if not exclusive recipients of capital injections,” and measures taken in the United Kingdom and Germany to promote credit throughout the economy may result in “the provision of credit solely to national actors.”

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industry.” It is conceivable that some of these measures will lead to international arbitrations.

A number of emerging markets also seem to be moving into the direction of a more restrictive regime:

- **China**: China strengthened its review system in August 2006, when the Government announced “Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors.” The regulation provides that approval is required if a foreign investor obtains actual control over a domestic enterprise if the transaction involves a critical industry, has or may have an impact on the country’s national economic security, or would result in the transfer of famous trademarks or traditional Chinese brands (none of these categories is defined). This new screening mechanism was further enhanced in November of that year when the 11th five-year plan of the National Development and Reform Commission responded to “perceived rising concern over foreign acquisitions of leading Chinese firms in critical sectors” by providing for “increased supervision of sensitive acquisitions to ensure what are termed ‘critical industries and enterprises’ remain under Chinese control.” The subsequent anti-monopoly law (which took effect in August 2008) “specifically provides that acquisitions of domestic enterprises by foreign investors that may have implications for national security shall be subject to not only competition review, but also national security review.”

- **Russia**: A 2008 law “On Procedures for Foreign Investments in Companies of Strategic Importance for National Defense and Security” requires government approval for certain transactions involving foreign investors if (i) the Russian company is engaged in an “activity of strategic importance to the country’s defense and national security” and

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28 Anne van Aaken and Jürgen Kurtz, “The global financial crisis: will state emergency measures trigger international investment disputes?” *Columbia FDI Perspectives, No. 3*, March 23, 2009, pp. 1, 2. The authors observe further (p. 2): “If this trend continues, there may be differentiation against foreign institutions as a matter of fact, even if not on the face of the law.”


(ii) the foreign investor would control either the company or rights to “natural resource deposits having federal importance.”

- **India**: The government recently introduced investment policy measures that include a requirement of prior approval for the transfer of ownership or control from resident Indian citizens to non-resident entities in specific sectors, including air transport services, banking, insurance and telecommunications.

These national actions are supplemented by supranational efforts, although these are voluntary in nature. Thus, the EU Commission has sought to complement the national approaches of members of the European Community, by formulating guiding principles concerning SWFs, supplemented by efforts to increase the transparency of SWFs. The OECD produced guidelines for host country investment policies relating to national security. Based on the principles of liberalization, non-discrimination, standstill, transparency, proportionality, and accountability, these guidelines underline at the same time the right and duty of host countries to take measures to protect national security.

Whether or not a situation involving national security exists is self-judging by the governments concerned. And the International Working Group of Sovereign Wealth Funds agreed in 2008 on “Generally Accepted Principles and Practices” for SWFs and submitted them to the IMF’s International Monetary and Financial Committee; it is expected that observance of these principles by sovereign wealth funds will persuade host country governments not to take restrictive actions.

Several features characterize most of these actions. For one, they seek to balance support for an open investment regime – the dominant approach -- with a desire to have sufficient flexibility to stop undesired foreign direct investments, typically involving cross-border M&As. The criterion most often used is, as already noted, “national security” or related concepts – but, and this is crucial, these concepts are not defined precisely but rather left open for definition by national governments. Screening mechanisms have the task to do that, but their decisions are typically the result of “black box” deliberations and often cannot be appealed. While this type of decision-making may work relatively

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32 The text of the law in Russian is available at http://www.rg.ru/2008/05/07/investicii-fz-dok.html.
35 “Sovereign Wealth Funds and Recipient Country Policies. Letter transmitting the Report of the OECD Investment Committee to G7 Finance Ministers.” The earlier version of the report of the OECD Investment Committee, adopted by it on April 4, 2008, is attached to this letter; it can also be found at http://www.oecd.org/dataoecd/34/9/40408735.pdf.
37 To quote the OECD (“Accountability for security-related investment policies” (Paris: OECD, November 2008), mimeo., p. 6): “The degree to which individual awards and procedures can be contested in courts or through administrative appeals mechanisms varies across countries. Some countries (e.g. Argentina, China, France, Germany, Korea, Lithuania and the United Kingdom) do allow rejected foreign investors to contest the security-related investment policy decisions in various ways. [footnote omitted]
A separate issue relates to regulatory decisions made on the basis of classified information. The need to safeguard national security may, in this case, militate toward either avoiding legal contestation altogether, curtailing the plaintiff’s right to subpoena and examine crucial evidence, or applying specific court procedures – or specialised courts – designed to safeguard the confidentiality of sensitive government
satisfactorily when the screening mechanism consists of representatives of government departments that reflect a plurality of interests, it may work less well when this is not the case, for example, where the executive branch or a representative thereof has the sole discretion to allow or block an investment (i.e., an explicit political, as opposed to administrative, process). In either event, moreover, such screening mechanisms, deciding on a case-by-case basis, make the investment climate less predictable and less transparent. However, it is clear that sovereign investors receive special attention, i.e., they are treated differently from domestic investors and private foreign direct investors, especially, it appears, when they are headquartered in emerging markets. Among other things, this reflects the fear (for which there is however no systematic evidence) that such investors pursue not only commercial interests but also political interests of the governments involved.38

While governments need of course the flexibility to pursue legitimate public policy objectives (be it national security, economic development or any other critical objective) and may have introduced regulatory provisions and mechanisms in good faith (namely to protect critical interests), the boundary line between protecting legitimate public policy objectives and protectionism is a fine one and, for that matter, not always easy to determine. The fuzziness of the key concepts involved inevitably creates the risk of abuse for protectionist purposes. This makes it all the more important to watch these new regulatory developments closely, especially since the rules that have been put in place leave considerable discretion to national policy makers, and their decisions often cannot be appealed. In fact, that governments think that it is necessary to put in place screening mechanisms suggests that their strong welcoming attitude of the past toward FDI is giving way to a certain caution (or at least to a more considerate approach) concerning such investment. Moreover, what is worrying is that developed countries are leading this change in approach, i.e., countries that had been, in the past, the champions of the liberalization of entry and operational conditions for foreign investors and the protection of investments under international law. If developed countries change their attitude toward FDI, this is likely to have a demonstration effect for emerging markets, leading the latter possibly also in the direction of protectionist measures.

It needs to be pointed out that governments recognize that investment protectionism is on the rise. In particular, the G-20 (in its communiqués issued in November 2008 and April

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38 Considerations of this kind may have played a role in the abortive attempt of CNOOC (China) to take over UNOCAL (US) and Huawei’s attempt to acquire a stake in 3Com (US). In light of the financial crisis and recession, it appears, however, that attitudes toward one class of foreign investors, SWFs, are becoming more welcoming, at least temporarily so. See Veljko Fotak and William Megginson, “Are SWFs welcome now?” Columbia FDI Perspectives, No.9, July 21, 2009.
2009) called for a moratorium on new investment protectionist measures.\textsuperscript{39} In its April 2009 declaration, it furthermore asked “the WTO, together with other international bodies, within their respective mandates, to monitor and report publicly on [the G-20 members’] adherence to these undertakings”; the urgency of this matter is underlined by the fact that the G-20 leaders requested that this reporting take place “on a quarterly basis.”\textsuperscript{40} It was further reaffirmed by the G-8 in their July 2009 declaration when that Group observed: “We will work to reverse the recent decline in FDI, by fostering an open, receptive climate for foreign investment, especially in emerging and in developing countries.”\textsuperscript{41} In its first document issued in response to the G-20 reporting request, then, UNCTAD observed that “[o]verall, .. investment policy developments paint a comforting picture,” but it also warned “there is no room for complacency. Indeed, a number of areas exist where caution in terms of protectionist dangers and investment distortions appears warranted.”\textsuperscript{42} UNCTAD drew particular attention to what it labels “‘smart’ protectionism,”\textsuperscript{43} in which, for example, a government takes advantage of gaps in investment regulations to discriminate against foreign investors.

Changes in the international investment regime

The changes at the national level are also leading to changes in the nature of the present international investment regime, for instance in the bilateral investment treaties that make up a substantial part of the regime. As already mentioned, at the core of this regime is the protection of foreign investors, based on the principle of non-discrimination of foreign investors (and, if discrimination takes place, the obligation to compensate investors). The changes that are underway in the international investment regime reflect those in process at the national level, by giving governments more flexibility to pursue national policies vis-à-vis FDI.

\textsuperscript{39} See, Group of 20, “Declaration: Summit on Financial Markets and the World Economy,” November 15, 2008 (available at http://www.whitehouse.gov/news/releases/2008/11/20081115-1.html). It said in the first paragraph of para. 13: “13. We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty. In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services….” This call for a moratorium was repeated in Group of 20, “The global plan for recovery and reform,” April 2, 2009 (available at http://www.g20.org/Documents/final-communique.pdf). In paragraph 22, the G-20 leaders reiterated: “We will not repeat the historic mistakes of protectionism in previous eras. To this end, we reaffirm the commitment made in Washington: to refrain from raising new barriers to investment or to trade in goods and services…. In addition we will rectify promptly any such measures. We extend this pledge to the end of 2010….”

\textsuperscript{40} Ibid., para. 22.

\textsuperscript{41} See, G-8 Leaders Declaration, “Responsible leadership for a sustainable future,” July 8, 2009, para. 49. In para. 50 (still in the Declaration’s Investment section) the leaders affirm: “Aware of the global nature of the markets where our citizens and businesses operate, and of the international effects of our actions, we fully stress our engagement against protectionist measures. In this light, we welcome OECD’s efforts to monitor restrictions on investments and encourage the ongoing joint work of the OECD Freedom of Investment Roundtable (FOI RT) with the WTO, the United Nations Conference on Trade and Development (UNCTAD) and the IMF, in this area.”

\textsuperscript{42} UNCTAD, “Investment policy developments in G-20 countries” (Geneva: UNCTAD, 2009), mimeo., paras. 25 and 27. UNCTAD also warns “there is a need to ensure that current endeavours against investment protectionism do not remain one-off initiatives.” Ibid., para. 28.

\textsuperscript{43} Ibid., para. 27.
Most indicative in this respect is the United States model bilateral investment treaty of 2004, if compared with the 1984 model. It weakens various protections that international investors had acquired through BITs and free trade and investment agreements and hence gives more rights to governments. In particular, it explicitly includes an “essential security” clause that is self-judging. In other words, the treaty partners decide on their own, and not subject to arbitral review, whether or not a given situation involves an essential security interest and therefore makes it not necessary to observe commitments contained in a given treaty.

Such an evolution of the international investment regime is understandable, given that governments seek more freedom to pursue what they consider to be important national objectives and given that they do not want to be penalized (through arbitral awards against them) for actions taken in this respect. But this greater respect for national policy priorities is also understandable from another perspective: the international investment regime as it has evolved over time has focused almost exclusively on the protection of international investors by granting them broad rights and few responsibilities, while host country governments assume broad responsibilities and have few rights.

The need for rebalancing
The critical challenge therefore is to find the right balance between the rights and responsibilities of foreign investors on the one hand and those of governments on the other. It needs to be a balance that combines the stability, predictability and transparency that firms need to make investment decisions with the policy space that governments need to pursue legitimate domestic policy objectives – a balance that does not open the door for measures that are primarily protectionist in nature.

Finding regulatory solutions to this challenge is not easy. It is important that the process of rebalancing, which is already underway, proceed in a manner that strengthens the overall international investment regime. Among other things, this requires a clarification of such concepts as “national interest” and “essential security interests,” as well as

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44 See Kenneth J. Vandevelde, “A comparison of the 2004 and 1994 U.S. model BITs: rebalancing investor and host country interests,” in *Investment Yearbook*, op. cit., pp. 283-316, and, even stronger, José E. Alvarez, “The once and future foreign investment regime,” in *Looking to the Future*, op cit. The 2004 U.S. model BIT was under review beginning in 2009; it may well be that the outcome is a further strengthening of the rights of host country governments.

45 The underlying logic for favoring protection of investors over preserving host country policy space is, among other things, that MNEs are, in any event, subject to the laws and regulations of host countries that can be enforced through national courts and that such a regime helps countries to attract FDI. For evidence regarding the latter expectation, see Karl P. Sauvant and Lisa Sachs, eds., *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (New York: Oxford University Press, 2009).

46 A survey by the OECD of a number of countries and their use of the concepts of “national security,” “essential security interests” and “public order” found that “the term ‘national security’ is shown to have a coherent and internationally understood meaning.” (See, OECD, “Security-related terms in international investment law and in national security strategies” (Paris: OECD, May 2009), mimeo., p. 4. If this finding regarding “national security” does, indeed, hold for a great number of countries, applies also to related
concepts such as “critical infrastructure”\footnote{See in this context OECD, “Protection of ‘critical infrastructure’ and the role of investment policies relating to national security” (Paris: OECD, May 2008), mimeo.} and “strategic sectors,” with a view toward arriving at an international consensus as to what these concepts encompass. If such a clarification process of a number of key concepts can be undertaken in an international organization, that would be desirable, involving as many countries as possible.\footnote{See in this context some of the publications prepared by the OECD Secretariat and referred to elsewhere in this chapter.} There is, of course, the risk that such an intergovernmental approach could become politicized, with countries merely restating their respective positions; still, it would be an important and desirable step forward.

A more ambitious approach would be to convene an international group of non-governmental experts from all regions of the world to arrive at something akin to the United States policy restatements.\footnote{The two approaches – an intergovernmental process and a process presumably involving primarily academic experts – are not mutually exclusive.} A "Restatement of International Investment Law" would show where there is convergence in the provisions of IIAs, including in terms of the rights and responsibilities of investors and States and the definitions of often-used terms-of-art in the IIAs. Even if consensus were found on aspects of international investment law, this does not mean that all governments would necessarily adopt those terms or definitions in the agreements they negotiate; in fact, they may deliberately want to leave certain terms (like “national security”) vague, in order to allow themselves flexibility for their national policies. For concepts and terms that still vary widely among IIAs, the Restatement could present alternative interpretations side-by-side, with explanations and commentary where possible. It is conceivable that indicating where the law continues to diverge and helping to explain the rationale could be a boost toward the harmonization of international investment law. And at the least, such a Restatement that clarified terms and outlined differences would be a valuable resource for investors and countries alike to understand better the complex investment law landscape, and a useful guide for arbitrators and negotiators of investment agreements.

Ultimately, however, a multilateral framework for investment is required to marshal the full strength of universal and consistent rules in this area, complemented by a functioning dispute settlement mechanism. As we know from the experience in the United Nations, OECD and WTO, the creation of a multilateral framework for investment is a very difficult task indeed, and one that – if pursued at all in the foreseeable future – will take considerable time.\footnote{Although, as the IMF SWF Principles show, rules can be formulated quite rapidly if important countries desire to do so. It is interesting to note in this context that the G-8, in its July 8, 2009 communiqué, noted: “… we commit to enhance cooperation with our major partners to agree upon shared principles which may serve as the basis for a more structured and wider process towards an agreed common multilateral framework in the long run creating a predictable and stable climate for investment. To this end, we commit to work with our HDP/HAP [Heiligendamm Dialogue Process/Heiligendamm L’Aquila Process] partners to produce in one year’s time a report on progress made in order to evaluate possible common responses, including the feasibility of launching a process with wide ownership, and with participation from relevant}
balanced manner the rights and responsibilities of investors and governments—would provide the most credible and coherent parameters for investment policy-making at the national level. And as national policies are as important in the international investment law regime as international agreements and treaties, a multilateral effort to define the parameters of such national policy-making would strengthen the overall regime significantly. While a multilateral investment agreement would be the most powerful instrument to guide national policy-making, even a Restatement, as discussed above, that illustrated areas of consensus and areas of weakness in the investment regime would help set useful parameters.

In the meantime, however, policy-making at the national level will continue to evolve on its own. It is clear from the foregoing discussion that a number of governments have put mechanisms in place that allow them, if need arises, to screen out specific FDI projects that, in their opinion, are not desirable. To what extent they will actually use these mechanisms only for the limited purpose of protecting legitimate national objectives – or, rather, will abuse them for protectionist purposes – is a matter for watchful waiting. International exhortations urging governments not to introduce FDI protectionist measures are of course important and need to be reiterated. At the same time, though, it would be highly desirable if watchful waiting and international exhortations were complemented by an independent FDI Protectionism Observatory to monitor new FDI protectionist measures and “name and shame” the countries that take them.51

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51 OECD, UNCTAD and the WTO monitor changes in investment laws regardless of the direction in which they go (see the earlier references). The Secretariats of international organizations have, however, the problem of pronouncing themselves about the nature of policy changes introduced by individual members, as their members will tend to resist that their actions are labeled “protectionist”; rather, members may prefer that these measures are characterized as “clarifications” and the like—which, in some cases, they may well be. It is in fact not always easy to determine whether a given measure is protectionist, intended or not; hence the task of such an Observatory (were it to be established) would need to be carried out in a very careful manner.