Policy statement

ICC recommendations to safeguard freedom of investment

Prepared by the Commission on Trade and Investment Policy

Introduction
ICC urges governments in all parts of the world to safeguard freedom of investment by avoiding investment protectionism and upholding their domestic and international commitments to welcome market-driven foreign investment.

Cross-border investment and openness of markets to receive such investment are essential to sustaining prosperity in developed and developing countries. This has been demonstrated in various studies by the World Bank and other international organizations. The benefits of foreign investment and open investment regimes have also been recognized by governments and enshrined in various intergovernmental instruments such as the Organisation for Economic Co-operation and Development's (OECD) *Declaration on International Investment and Multinational Enterprises*.

In the past few years, there has been a sharp increase of cross-border investment worldwide. According to the United Nations Conference on Trade and Development (UNCTAD), the total value of global foreign direct investment (FDI) inflows soared in 2006 to reach US $1,306 billion, an increase of 38% compared to the previous year.[1] This growth was fuelled in large part by cross-border mergers and acquisitions.

Concern over the worldwide increase in investment protectionism
In parallel with this increased cross-border investment activity, the markets have witnessed a rise in investment protectionism -- and in the potential for investment protectionism -- in both industrialized and emerging economies. In its 2006 and 2007 annual surveys of changes in national laws and regulations relevant to foreign direct investment, UNCTAD noted that the proportion of these changes that made host countries less welcoming to foreign direct investment has been rising steadily from 5% in 2002 to a peak of 20% in 2005 and remained at this 20% peak in 2006.[2] This trend is manifesting itself in the following ways:

- legislation, the misuse of legislation or consideration of legislation to tighten rules on foreign investment,
- protection and enhancement of "national champions" impeding foreign investment or forcing the sale of foreign investment to the state, and
- the use of informal measures and political pressure to impede or deny foreign investment activity.

[1] United Nations Conference on Trade and Development, World Investment Report 2007, page xv
[2] Ibid. page 15 and United Nations Conference on Trade and Development, World Investment Report 2006, page 25

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The International Chamber of Commerce (ICC) – the world business organization -- is very concerned that these actions dampen the climate for the relatively free flow of foreign investment, and reduce the benefits it brings to home and host countries.

Government regulation should be "least investment-restrictive"

While governments of sovereign nations have a right to regulate economic activity and protect national security with respect to cross-border investment, it is critical that they do so in a manner that does not impede unnecessarily the overall cross-border flow of investment and/or disrupt the benefits it brings to home and host countries. Where regulations establish a review process, the process should be fact-based, analytically rigorous, and directed to individual transactions. Further, such processes should assure procedural and legal certainty by being timely, transparent and non-discriminatory and by providing finality for the investing parties.

In those few instances where a government review concludes that action should be taken to protect national security, governments should first exhaust the use of existing rules and regulations before adopting any special measure, since existing rules are usually sufficient to cover all relevant risks. When, however, special measures are deemed necessary, they should be strictly proportional to the identified national security risk inherent in the transaction and limited to only what is required to meet that risk.

All governments must remain committed to freedom of investment and the promotion of an open investment environment worldwide. In June 2007, G8 leaders invited major emerging economies *"to participate in a structured High Level Dialogue on investment conditions in industrialized countries and emerging economies [starting with] a stocktaking exercise, an examination of best practices and the implementation of peer review mechanisms to promote an open, efficient investment environment that aims to remove remaining barriers to investment".*[3] ICC welcomes this initiative, which world business expects will produce concrete results.

Much work has already been done in intergovernmental organizations, including the OECD and UNCTAD, both on identifying and disseminating good regulatory practice and on peer review mechanisms. The G8 mandate should seek to build on this existing body of work. Governments should involve in these discussions representative global business organizations whose members have much experience in advising governments and intergovernmental organizations on improving conditions for cross-broder investment.

[3] G8 Summit 2007 Heiligendamm, "Growth and responsibility in the world economy", page 5, paragraph 15.

Sovereign wealth funds: opportunities and challenges

Concurrent with the increase of cross-border investment flows, the scale and scope of the cross-border investment activities of governments through so-called "sovereign wealth funds" (SWFs) have increased substantially and are set to continue to grow according to a recent report, which estimates their value at US $ 2.2 trillion.[4] While SWFs differ in several respects, their main common characteristic for the purposes of this policy statement is that they are state-backed vehicles into which governments channel funds either earned through exports of natural resources or accumulated in foreign exchange reserves. Another key feature of SWFs is that, as part of their investment diversification and optimisation strategies, they are increasingly purchasing stakes in foreign companies.

SWFs may generate benefits for both home and host countries. For their home countries, SWFs may perform useful functions including: shielding the economy against volatility in commodity markets of critical value for the country, diversifying national wealth, optimising governments' risk-return profile on national wealth, and increasing transparency and accountability through greater scrutiny of public finances.[5] For host countries, SWF investments offer additional capital that helps businesses to develop and create jobs. Importantly, some SWFs have shown themselves to be reliable and stable investors for many companies across a broad range of sectors.

Additionally, SWFs can help reduce capital market volatility by providing a valuable pool of long-term capital, thereby contributing to the stability of the international financial system and of the global economy.

However, increased investment activism by some governments through SWFs may pose some potential challenges. Although SWFs have existed for some time, they have recently attracted growing attention from policy makers and concerns about their activities have been one of the driving forces behind the tightening of foreign investment rules in industrialized countries. Those concerns include the following:

- *Transparency/financial stability:* Questions have been raised about the relative lack of transparency of SWFs and the need for them to state explicitly their strategies (values and missions) in order to make their aims and actions more transparent to all economic actors, especially in the societies where these funds invest.

- *Political versus commercial considerations:* There is a risk that some SWFs may operate not only on the basis of commercial interest but may also be driven by political or foreign policy considerations. This risk needs to be addressed in order to avoid a potential protectionist backlash, to ensure that markets remain open to foreign investments by SWFs and that the principle of non-discriminatory market access for foreign direct investment is effectively upheld.

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[4] Standard Chartered Bank, "State capitalism: the rise of sovereign wealth funds", 15 October 2007.
[5] Deutsche Bank Research, "Sovereign wealth funds – state investments on the rise", 10 September 2007, pages 4-5.

- *Preferential access to capital:* Another concern arising from the increased activities of SWFs is their preferential access to capital and the competitive disadvantage at which this may place private companies. Private sector competitors have already lost out on takeover transactions in their markets when competing with foreign entities which have an element of government subsidy in their financial package. This practice may increase and create tension in the markets as governments with large reserves and current account surpluses shift their investments from the holding of foreign government securities to foreign equity investments.

Increased attention to these and other issues has led policy makers to actively consider the possibility of establishing an internationally agreed set of best practices to guide the management by governments of their international investments through SWFs.

G7 Finance Ministers and Central Bank Governors meeting in October 2007 in Washington *"agreed that sovereign wealth funds (SWFs) are increasingly important participants in the international financial system and that our economies can benefit from openness to SWF investment flows. We see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability. For recipients of government-controlled investments, we think it is important to build on principles such as non-discrimination, transparency and predictability. We ask the IMF, World Bank and OECD to examine these issues."*[6]

World business as represented by ICC considers it essential that such best practices uphold and strengthen an open, stable and non-discriminatory international investment regime by improving the predictability, accountability and transparency of the cross-border investment activities of governments, with due consideration of the potential benefits and challenges that such investments may bring. Such international best practices should be developed through a process of intergovernmental collaboration and coordination among intergovernmental organizations (including the International Monetary Fund, OECD, UNCTAD, and the World Bank), and in consultation with global business given its preponderant interest in safeguarding the freedom of cross-border investment.[7]

ICC recommendations

In light of the above, ICC makes the following recommendations to governments:

- to act in ways that keeps doors open to foreign investment and to recommit to open investment in order to preserve and protect what they have already reaped in the way of benefits from international investment;

[6] Statement of G7 Finance Ministers and Central Bank Governors, Washington, 19 October 2007

[7] ICC believes that open and just societies involve stakeholders in the policy-creation process and examine the ramifications of the long-term effects and benefits of proposed changes. The principles of better regulation, clarity, transparency, consultation and evaluation should be followed in all cases. ICC does not believe that SWFs represent a special case that would allow for the departure from these principles of better regulation.

- to observe, in their investment policies, the principles of non-discrimination, proportionality, transparency, predictability, and accountability and to avoid unnecessary restrictions to international investment, including for national security reasons and by SWFs; and
- to increase multilateral cooperation among countries in intergovernmental fora, including the private sector, to promote an open and efficient international investment environment and the removal of remaining barriers to foreign investment.

ICC also makes the following recommendations with regard to SWFs[8]:

- SWFs should be transparent about their investment policies by disclosing publicly information about their purpose, fiscal treatment, governance structure and investment process;
- SWFs should commit, as part of their investment management policies, to base their investment decisions solely on commercial grounds, and not on political or foreign policy considerations;
- SWFs should support and participate in intergovernmental efforts to develop a set of best practices for SWFs, in order to mitigate potential systemic risks, contribute to a better understanding of the expectations of home and host countries including the issue of SWFs' preferential access to capital/competition with the private sector, and demonstrate their willingness to continue to make a positive contribution to the international financial system.

Conclusion

Over the years, the global economy has witnessed a sharp diminution in the barriers to foreign investment as governments have welcomed foreign investors to bring their capital, technology, and management expertise to generate economic growth and jobs. This positive contribution of foreign investment to economic growth, employment creation and rising living standards, which is broadly recognized by governments worldwide, must be safeguarded by a strong commitment by governments, *in words and in deeds,* to freedom of investment and the avoidance of protectionist measures.

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About ICC

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy, and helps business corporations meet the challenges and opportunities of globalization. Business leaders and experts drawn from ICC's global membership establish the business stance on broad issues of trade and investment policy as well as on vital technical subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations in 130 countries.

[8] See Robert M. Kimmit, "Public footprints in private markets: sovereign wealth funds and the world economy", Foreign Affairs, Volume 87 No 1, pages 126-129.