SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRIES - Working together to maintain and expand freedom of investment

MESSAGE BY THE OECD SECRETARY-GENERAL TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE, 11 OCTOBER 2008, WASHINGTON

OECD and partner countries welcome investments from Sovereign Wealth Funds (SWFs) as a positive force for development and global financial stability. Last June at the OECD, Ministers representing thirty-three recipient countries adopted a Declaration to express their commitment to preserve and expand an open international investment environment for SWFs. This commitment is grounded in the long-standing OECD investment policy principles of non-discrimination, transparency and liberalisation. In this context, they also endorsed guidelines developed under the auspices of the OECD Investment Committee to ensure that investment measures to safeguard national security are not, in fact, disguised protectionism.

This document presents the Ministerial Declaration and the associated OECD guidance for recipient country policies towards SWFs. These commitments by OECD and partner countries will help to preserve freedom of investment and global prosperity.

The elaboration by the International Working Group of SWFs of Generally Accepted Principles and Practices (GAPP) for SWFs' appropriate governance, accountability and investment conduct is also essential. The OECD is very pleased to have been invited to observe this work and to provide inputs to the GAPP.

Taken together, the OECD guidance to recipient countries and the GAPP for SWFs provide the international community with a robust framework for promoting mutual trust and confidence and reaping the full benefits of SWFs for home and host countries. As countries face major financial turbulence, it is all the more important to keep capital inflows moving freely.

The broader Freedom of Investment process, launched in 2006 at the OECD, but involving many other countries, provides a unique multilateral forum for investment policy dialogue. It includes a process of peer surveillance to ensure that international commitments to openness are respected. The initiative is presented in this document. I invite SWFs and their governments to participate actively in this process. The OECD looks forward to continuing dialogue and co-operation between recipient countries and SWFs.

Angel Gurría
OECD Secretary-General

Prepared for distribution at the meeting of the International Monetary and Financial Committee, 11 October 2008, Washington

OECD DECLARATION ON SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

At the OECD Ministerial Council Meeting on 4-5 June 2008 in Paris, Ministers of OECD countries*

- Welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven investors and a force for global financial stability.
- Recognised that if SWF investments were motivated by political rather than commercial objectives, they could be a source of concern, and that legitimate national security concerns could arise.
- Welcomed international discussions involving SWFs, their governments and recipient governments. These increase understanding, contribute to mutual trust and confidence, and help avoid protectionist responses that could undermine economic growth and development.
- Noted that the home countries of SWFs and SWFs themselves can enhance confidence by taking steps to strengthen transparency and governance in the SWFs.

Christine Lagarde, Chair of the OECD Ministerial Council Meeting and Angel Gurría, OECD Secretary-General

- Supported the work of the IMF on best practices for SWFs as an essential contribution and the continuing coordination between the OECD and the IMF.
- Noted that the OECD for its part has been working on best practices for recipient countries. Together the IMF and OECD will help preserve and expand an open international investment environment for SWFs while safeguarding essential security interests.
- Welcomed the Report by the OECD Investment Committee on SWFs and Recipient Country Policies**, which reflects inputs from both OECD and emerging economies, and looked forward to future work, including peer monitoring of policy developments and broader consideration of foreign-government controlled investments.
- Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment. They are consistent with OECD countries' rights and obligations under the OECD investment instruments.
    - ♦ Recipient countries should not erect protectionist barriers to foreign investment.
    - ♦ Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
    - ♦ Where such national security concerns do arise, investment safeguards by recipient countries should be:
        - transparent and predictable,
        - proportional to clearly-identified national security risks, and
        - subject to accountability in their application. ■

* Ministers of Chile, Estonia and Slovenia also adhered to this Declaration in the name of their government on 5 June 2008.

** This report was issued in April 2008. Developed at the request of the G7 Finance Ministers and the other OECD members in October 2007 to develop guidance for recipient countries' policies toward investments from sovereign wealth funds (SWFs), it is the result of the work of the thirty OECD countries, ten non-OECD countries adhering to the OECD investment instruments, four other governments participating in the project and the European Commission. The report also benefited from consultations with SWFs and business and social partners.

OECD GENERAL INVESTMENT POLICY PRINCIPLES

The OECD general investment policy principles are established in the OECD Code of Liberalisation of Capital Movements, adopted by the OECD country governments in 1961, and the OECD Declaration on International Investment and Multinational Enterprises of 1976 as revised in 2000, adopted by forty-one OECD and non-OECD country governments. They apply to treatment of all foreign investors, including SWFs, and are as follows:*

- *Non discrimination.* Foreign investors are to be treated not less favourably than domestic investors in like situations. While the OECD instruments protect directly the investment freedoms of those SWFs established in OECD member countries, they also commit members to using their best endeavours to extend the benefits of liberalisation to all members of the International Monetary Fund. Experience has shown that, in practice, OECD governments nearly always adopt liberalisation measures without discriminating against non-OECD countries -- investors from non-member countries reap the same benefits of free market access as OECD residents. Outright discrimination against non-OECD based investors would be a major departure from OECD tradition.
- *Transparency.* Information on restrictions on foreign investment should be comprehensive and accessible to everyone.
- *Progressive liberalisation.* Members commit to the gradual elimination of restrictions on capital movements across their countries.
- *"Standstill".* Members commit to not introducing new restrictions.
- *Unilateral liberalisation.* Members also commit to allowing all other members to benefit from the liberalisation measures they take and not to condition them on liberalisation measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition. The OECD instruments are based on the philosophy that liberalisation is beneficial to all, especially the country which undertakes the liberalisation. ■

Governments adhering to the OECD Declaration on International Investment and Multinational Enterprises

Argentina
Australia
Austria
Belgium
Brazil
Canada
Chile
Czech Republic
Denmark
Egypt
Estonia
Finland
France
Germany
Greece
Hungary
Iceland
Ireland
Israel
Italy
Japan
Korea
Latvia
Lithuania
Luxembourg
Mexico
The Netherlands
New Zealand
Norway
Peru
Poland
Portugal
Romania
Slovak Republic
Slovenia
Spain
Sweden
Switzerland
Turkey
United Kingdom
United States

* Source: OECD Investment Committee report on recipient country policies and SWFs, approved by governments on 4 April 2008.

OECD GUIDELINES FOR RECIPIENT COUNTRY INVESTMENT POLICIES RELATING TO NATIONAL SECURITY*

Non-discrimination – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.

Transparency/predictability – while it is in investors' and governments' interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.

- *Codification and publication*. Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register; on internet). In particular, evaluation criteria used in reviews should be made available to the public.
- *Prior notification*. Governments should take steps to notify interested parties about plans to change investment policies.
- *Consultation*. Governments should seek the views of interested parties when they are considering changing investment policies.
- *Procedural fairness and predictability*. Strict time limits should be applied to review procedures for foreign investments. Commercially-sensitive information provided by the investor should be protected. Where possible, rules providing for approval of transactions if action is not taken to restrict or condition a transaction within a specified time frame should be considered.
- *Disclosure of investment policy actions* is the first step in assuring accountability. Governments should ensure that they adequately disclose investment policy actions (e.g. through press releases, annual reports or reports to Parliament), while also protecting commercially-sensitive and classified information.

Regulatory proportionality - Restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.

- *Essential security concerns are self-judging*. OECD investment instruments recognise that each country has a right to determine what is necessary to protect its national security. This determination should be made using risk assessment techniques that are rigorous and that reflect the country's circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear.
- *Narrow focus*. Investment restrictions should be narrowly focused on concerns related to national security.
- *Appropriate expertise*. Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions.
- *Tailored responses*. If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals. This would include providing for policy measures (especially risk mitigation agreements) that address security concerns, but fall short of blocking investments.

continued…

* Source: OECD Investment Committee report on recipient country policies and SWFs, approved by governments on 4 April 2008. The text on accountability was finalised by governments at the 8th Roundtable on Freedom of Investment which took place under the auspices of the OECD Investment Committee on 8 October 2008. OECD countries that have SWFs are participants in the roundtables on Freedom of Investment. Non-OECD SWFs are also invited.

- *Last resort.* Restrictive investment measures should be used, if at all, as a last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

Accountability – procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels should be considered to ensure accountability of the implementing authorities.

- *Accountability to citizens*. Authorities responsible for restrictive investment policy measures should be accountable to the citizens on whose behalf these measures are taken. Countries use a mix of political and judicial oversight mechanisms to preserve the neutrality and objectivity of the investment review process while also assuring its political accountability. Measures to enhance the accountability of implementing authorities to Parliament should be considered (e.g. Parliamentary committee monitoring of policy implementation and answers or reports to Parliament that also protect sensitive commercial or security-related information).

- *International accountability mechanisms*. All countries share a collective interest in maintaining international investment policies that are open, legitimate and fair. Through various international standards, governments recognise this collective interest and agree to participate in related international accountability mechanisms (e.g. the OECD notification and peer review obligations in relation to restrictive investment policies). In particular, these help constrain domestic political pressures for restrictive and discriminatory policies. Recipient governments should participate in and support these mechanisms.

- *Recourse for foreign investors.* The possibility for foreign investors to seek review of decisions to restrict foreign investments through administrative procedures or before judicial or administrative courts can enhance accountability. However, some national constitutions' allocation of authority with respect to national security may place limits on the scope of authority of the courts. Moreover, judicial and administrative procedures can be costly and time-consuming for both recipient governments and investors, it is important to have mechanisms in place to ensure the effectiveness, integrity and objectivity of decisions so that recourse to such procedures is rare. The possibility of seeking redress should not hinder the executive branch in fulfilling its responsibility to protect national security

- *The ultimate authority for important decisions (e,g, to block foreign investments) should reside at a high political level*. Such decisions require high-level involvement because they may restrict the free expression of property rights, a critical underpinning of market economies, and because they often require co-ordination among numerous government functions. The final decision to prohibit (or block) an investment should be taken at the level of heads of state or ministers.

- *Effective public sector management*. Broader public sector management systems help ensure that the political level officials and civil servants responsible for security-related investment policies face appropriate incentives and controls for ensuring that they exercise due care in carrying out their responsibilities and are free from corruption, undue influence and conflict of interest. ■

FREEDOM OF INVESTMENT PROCESS: PRESERVING THE FOUNDATIONS OF GLOBAL PROSPERITY AND DEVELOPMENT

In recent years, governments have tightened their policies toward international investment in response to a changing context for national security and the emergence of new players, including large investors controlled by foreign governments. Protectionist responses will undermine the foundations for global prosperity and development. Countries, both OECD and non-OECD, need to maintain open environments for international investment and manage globalisation co-operatively and responsibly and to learn to work together to this effect.

The Freedom of Investment (FOI) process, launched at the OECD in 2006, helps governments to reconcile the need to preserve and expand an open international investment environment with their duty to safeguard the essential security interests of their people.

Focus of FOI roundtable discussions

- *Tour d'horizon* of recent national developments
- Policy transparency, proportionality and accountability
- "Critical infrastructure", energy supply
- Identification of the ultimate beneficiary owner; investors' information disclosure
- Foreign government controlled investment; sovereign immunity
- National security and public order under international investment law
- Restrictive private practices

Multilateral forum for investment policy

The FOI process involves the thirty OECD members, the European Commission, Brazil and the ten other non-member adherents to the OECD Declaration on International Investment and Multinational Enterprises and other major country partners, including China, India, Russia and South Africa. Governments which have sovereign wealth funds (SWFs) are invited.

Eight FOI roundtables have been held so far where governments compare policies and agree on improved practices. Guidance for recipient country investment policies relating to national security has been issued and led to the adoption of a Ministerial Declaration on SWFs at the OECD in June 2008.

Peer surveillance

The FOI process has a strengthened peer monitoring of country developments. This includes country notifications and deadlines for responding to Secretariat enquiries, roundtable question & answer sessions, and published accounts of the discussions.

In addition, countries that have adhered to the binding Codes of Liberalisation of Capital Movements and the Declaration on International Investment and Multinational Enterprises are subject to mandatory notification and examination procedures and oversight by the Council, the governing body of the OECD.

Public international database

The positions of all OECD and other countries adhering to the OECD legal instruments, including FDI screening, sectoral restrictions and national security measures, are already publicly available.

The FOI process is developing a comprehensive repertoire of information on investment policy measures in OECD and non-OECD countries. ■

Key documents available online:

- Investment Committee report on Freedom of Investment, National Security and 'Strategic' Industries, *April 2008*
- Investment Committee report on Sovereign Wealth Funds and Recipient Country Policies, *April 2008*
- OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies, *June 2008*

www.oecd.org/daf/investment/foi

REFERENCES

OECD legal investment instruments can be accessed on the OECD website at www.oecd.org/daf/investment/instruments:

- OECD Code of Liberalisation of Capital Movements, 1961
- OECD Declaration on International Investment and Multinational Enterprises and related Decisions, including National Treatment, 1976-2000
- OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies, 2008

Freedom of Investment documents are available on the OECD website at www.oecd.org/daf/investment/foi, unless specified otherwise:

- Sovereign Wealth Funds and Recipient Country Policies: Report by the Investment Committee, April 2008
- Freedom of Investment, National Security and "Strategic" Industries: Progress Report by the Investment Committee, April 2008
- Transparency and predictability for investment policies addressing essential security interests: A survey of practices, April 2008
- Proportionality of security-related investment instruments: A survey of practices, May 2008
- Accountability of security-related investment policies, October 2008 (forthcoming)
- Protection of 'critical infrastructure' and role of investment policies relating to national security, May 2008
- Government-controlled investors and recipient country investment policies, October 2008 (forthcoming)
- Competition, International Investment and Energy Security, April 2008
- Summary reports of OECD Roundtables on *Freedom of Investment, National Security and "Strategic" Industries*
- Consultations on Freedom of Investment, National Security and "Strategic" Industries: Submissions by BIAC www.biac.org and TUAC www.tuac.org
- Economic and other impacts of foreign corporate takeovers in OECD countries, *International Investment Perspectives, OECD, 2007*
- Essential Security Interests under International Investment Law, *International Investment Perspectives, OECD, 2007*

FURTHER INFORMATION

OECD work on
Freedom of Investment:
www.oecd.org/daf/investment/foi

Requests for information can be addressed to:

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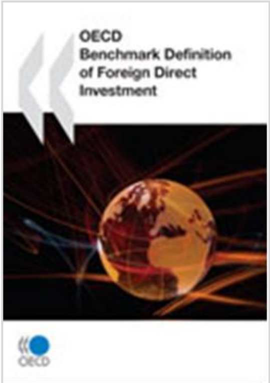
International Investment Law:
Understanding Concepts and Tracking Innovations

International investment agreements set ground rules for how host governments treat foreign investors. This publication provides an unparalleled source of information on four key issues: the definition of investor and investment; the interpretation of umbrella clauses in investment agreements; coverage of environmental, labour and anti-corruption issues; and the interaction between investment and services chapters in regional trade agreements.

2008 OECD Investment Policy Review of China
Encouraging responsible business conduct

This third review includes a full assessment of Chinese government efforts to encourage responsible business conduct against the background of recent regulatory changes and China's increasing outward investment.

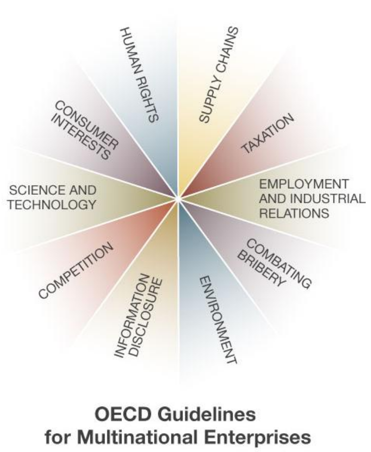


OECD Benchmark Definition of Foreign Direct Investment

Recording comprehensive, comparable and up-to-date statistics on Foreign Direct Investment is a prerequisite for economic analysis and policy making. The Fourth Edition of the OECD *Benchmark Definition*, Sixth Edition, provides operational guidance on how FDI data should be compiled to meet internationally agreed standards.

The OECD Journal of Investment Policy

This publication focuses on multidisciplinary empirical and analytical research of practical relevance for the global investment policy community. While all of the papers share the common theme of best practices in promoting investment for development, together they also illustrate the broad range of investment policy issues that governments need to consider as they pursue their objectives.



2008 Annual Report on the OECD Guidelines for Multinational Enterprises
Employment and Industrial Relations

This publication provides an account of the actions the 41 adhering governments have taken over the 12 months to June 2008 to enhance the contribution of the *Guidelines* to the improved functioning of the global economy.

A companion volume publishes key findings from the high-level OECD-ILO conference on *Employment and industrial relations: promoting responsible business conduct in a globalising economy*.

Several options are available for obtaining publications:

Additional information and links can be found via the investment portal on the OECD website: www.oecd.org/investment

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