VALE COLUMBIA CENTER
ON SUSTAINABLE INTERNATIONAL INVESTMENT
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND
THE EARTH INSTITUTE AT COLUMBIA UNIVERSITY

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment
No. 25, June 17, 2010
Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Editor: Lisa Sachs (Lsachs1@law.columbia.edu)
Managing Editor: Amanda Barnett (ab3089@columbia.edu)

The response to the global crisis and investment protection: evidence

by
Kathryn Gordon and Joachim Pohl*

In March 2009, *Columbia FDI Perspectives* carried an early analysis of investment policies in response to the financial crisis that began in early 2008.[1] At that time, the authors, Anne van Aaken and Jürgen Kuntz, found "clear evidence of widespread discrimination directed at foreign actors" in the emergency response to the crisis.

One year on, OECD analysis suggests a more nuanced assessment of investment policy making during the crisis. The findings of a series of OECD reports[2] tracking investment policy trends in 49 developed and emerging markets since November 2008 challenge the wholesale claim that investment policy measures taken during the crisis were driven by a protectionist agenda involving significant discrimination against foreign investors. However, in the current context, the OECD inventory of investment measures also shows that crisis response and exit policies (that is, policies that unwind crisis response measures) pose a major threat to the openness of international investment.

Fears of a destructive spiral of investment protection and retaliationhave not materialized

As the crisis deepened in 2008, fears took hold of a destructive cycle of protectionist and retaliatory policies of the type experienced in earlier deep crises[3]. In retrospect, these fears proved largely unfounded. General investment measures – those not covered by national security or crisis exceptions –

---

* Kathryn Gordon (kathryn.gordon@oecd.org) and Joachim Pohl (joachim.pohl@oecd.org) are officials in the Investment Division of the OECD. The authors wish to thank Anne van Aaken, Ted Posner, and an anonymous reviewer for their helpful comments on this *Perspective*. **The views expressed by the individual authors of this *Perspective* do not necessarily reflect the opinions of the OECD, Columbia University or their partners and supporters. *Columbia FDI Perspectives* is a peer-reviewed series.**

1 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.

2 The reports are available at www.oecd.org/daf/investment/foi. A series reports on G20 trade and investment policies jointly produced by the WTO, OECD and UNCTAD are also available at this address.

3 See "Keeping markets open at times of crisis" OECD Policy Brief April 2009 for a discussion of protectionist risks and appropriate investment policies during economic crises. http://www.oecd.org/dataoecd/18/44/42446696.pdf

taken since the outbreak of the global crisis point, with few exceptions, toward greater openness and transparency for foreign investors. Governments streamlined investment review procedures, loosened limits on foreign ownership in domestic companies and abolished monopolies that had previously limited foreign investments. The OECD found several dozen general investment measures, of which only a few restrict inward or outward investment.

Crisis measures have pervasive impacts on inward and outward capital flows

While general investment policy changes tended to promote international investment, the many crisis response measures that governments introduced to rescue or support companies bear significant potential for discrimination against foreign investors. Except for a few emerging markets, almost all countries in the OECD inventory established such schemes since late 2008, and new measures were still being introduced in early 2010. A conservative OECD estimate found that, by September 2009, G20 governments alone had made combined public expenditure commitments of more than USD 3 trillion to assist companies in difficulty – roughly USD 10 billion per day on average since the dramatic deepening of the crisis in autumn 2008. By early 2010, several thousand companies had received financial support or were expected to benefit from support schemes.

The massive support measures influence worldwide capital flows in various ways: by affecting the pattern of entry and exit in globalized sectors such as finance and automobiles or via direct governmental participation in firms' investment decisions by virtue of control rights conferred by shareholdings acquired as part of crisis response policies.

Emergency measures pose a serious threat to open investment

While emergency measures have almost certainly influenced international capital flows, their discriminatory or protectionist intent or effect is less certain. Indeed, the design and implementation of emergency measures varies significantly among countries. In addition, the determination of what is non-discriminatory treatment can be a subtle one, especially in the financial sector. Under OECD investment dialogue, policies such as "fit" and "proper" tests of general application, financial requirements for non-residents' branches equivalent to levels applied to domestic entities, rules for consolidated supervision and the non-extension of emergency lending facilities to non-residents' branches are not necessarily considered discriminatory. Under this approach[4], the OECD inventory finds that most crisis response schemes are designed to be non-discriminatory, i.e. they are *de jure* designed to be open to participation by foreign-controlled companies.

However, even those support schemes that are *de jure* open to foreign controlled enterprises may be administered in a discriminatory manner. Crisis response poses a dilemma for policy makers – they need to take action, but most options for crisis response pose grave risks for public sector transparency and market competition. The implementation of most schemes involved significant discretion for the implementing authorities; many governments participated directly in one-on-one negotiations with companies on conditions for rescue or mergers – over 100 business-government negotiations are recorded in the OECD inventory. While confidential, one-on-one negotiations may have helped protect companies

[4] The OECD methodology does not assume that prudential measures (and measures taken to safeguard essential security interests) are protectionist – such measures may be taken to address legitimate concerns, but they may also be used to camouflage protectionist intent. Because these measures exist in a kind of grey zone in terms of motivation, they are subject, under OECD rules, to enhanced scrutiny and to peer review. The OECD treatment of such measures, which differs from earlier studies, may explain some of the differences between the OECD findings and those of other reports such as the van Aaken and Kurtz report cited above.

involved in rescue negotiations, they are also inherently non-transparent and may cover discrimination and complicate public scrutiny of such measures.

The risk of discrimination has not abated – 'exit' is the next challenge

The "exit" phase of crisis response involves the dismantling of policies and the unwinding of stakes in companies acquired in the course of crisis management. The OECD inventory shows that the introduction of new crisis response schemes has significantly slowed, and exit from emergency measures, especially in the financial sector, has begun in some countries. However, the risks of discriminatory treatment of foreign controlled enterprises have not declined.

Ongoing implementation of rescue and support schemes perpetuates the abovementioned risks, albeit arguably at a smaller scale as rescue operations of most large companies are concluded. New risks arise in the exit phase that is only just beginning: governments that have acquired financial positions will decide on the timing and modalities of divestments and will have to select from among the potential acquirers of the assets. The risks from governments' discretion in administering the exit process raise concerns similar to those of the rescues of large financial institutions in the early stages of the crisis. Furthermore, until the public financial positions in companies are unwound, governments will also need to manage tensions between their roles as owners of companies and their roles in regulation, taxation and law-enforcement.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Lisa Sachs, Assistant Director, (212) 854-0691, Lsachs1@law.columbia.edu.

The Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

Most recent *Columbia FDI Perspectives*

- No. 24. Mark Plotkin and David Fagan, "Foreign direct investment and U.S. national security: CFIUS under the Obama Administration," June 7, 2010.
- No. 23. Gus Van Harten, "Thinking twice about a gold rush: Pacific Rim v. El Salvador," May 24, 2010.
- No. 22. Premila Nazareth Satyanand, "How BRIC MNEs deal with international political risk," May 5, 2010.
- No. 21. Armand de Mestral, "Is a model EU BIT possible—or even desirable?," March 24, 2010.
- No. 20. José Guimón, "It's time for an EU Investment Promotion Agency," March 4, 2010.
- No. 19. Kevin P. Gallagher, "U.S. BITs and financial stability," February 23, 2010.

All previous *FDI Perspectives* are available at http://www.vcc.columbia.edu/content/fdi-perspectives