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Research Report

The times they are a-changin' – again – in the relationships between governments and multinational enterprises: From control, to liberalization to rebalancing

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The times they are a-changin' -- again -- in the relationships between governments and multinational enterprises: From control, to liberalization to rebalancing

by

Karl P. Sauvant*

Governments seek to attract foreign direct investment (FDI) undertaken by multinational enterprises (MNEs) because it contributes to the growth of their economies; they seek to maximize the benefits of this investment in the framework of their national economies. Firms undertake FDI because it improves their access to markets and resources and hence increases their international competitiveness; they seek to maximize the benefits of this investment in the framework of their global corporate networks. This difference in objectives and frameworks gives rise to tensions that play themselves out in the approach governments take in national FDI policies and bilateral investment treaties (BITs). During the late 1960s and the 1970s, the dominant approach was to control MNEs. During the 1990s, it was liberalization -- and the approach is again changing.

Consider:

- During the 1990s, 95% of 1,035 national FDI policy changes worldwide¹ made the investment climate more welcoming for MNEs.

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¹ UNCTAD, *World Investment Report* (Geneva: UNCTAD, various years).

- National FDI screening agencies were replaced by investment promotion agencies (IPAs) -- red carpets replaced red tape.
- Reflecting this national approach, the number of BITs -- geared entirely toward protecting foreign investors and, in this manner, hoping to attract more FDI -- rose from 370 in 1989 to 1,719 in 1999.²

Thus, by the end of the 1990s, FDI was widely regarded as part of the solution to advancing economic development. Virtually all governments had liberalized their FDI regulatory frameworks, established IPAs and signed BITs. Since then, countervailing considerations are asserting themselves.

Consider:

- The share of national FDI policy changes worldwide that made the investment climate less welcoming rose from 6% in 2001-2002, to 12% in 2003-2004, to 20% in 2005-2006, to 23% in 2007-2008, and to 32% in 2009-2010.³
- A number of countries (particularly developed ones) have strengthened their screening mechanisms of incoming mergers and acquisitions (M&As), in the process also distinguishing between types of investors by singling out state-controlled entities (SCEs). For example, the number of investigations by the Committee for Foreign Investment in the United States rose from 1 in 2000 to 35 in 2010.⁴
- The investment regime seems to be fragmenting as well, with separate rules emerging for SCEs.
- Reflecting the new approach at the national level, the international investment regime itself is becoming less protective of MNEs. In particular, the US (but not yet many other countries) has narrowed certain substantive protections of foreign investors, especially fair and equitable treatment and indirect expropriation; abandoned the umbrella clause; and strengthened the essential security interest clause (which allows governments to disregard BIT commitments under certain circumstances).

Thus, a growing number of governments are now taking a more nuanced approach to the role of FDI in their economies. While they continue to liberalize their FDI policies and conclude BITs, there is a clear trend to make the investment climate less welcoming and less predictable.

What explains this change in approach?

- The consensus that all FDI is equally beneficial is changing as more governments consider (certain) M&As as less beneficial than greenfield investments; conversely, in the future they may encourage more sustainable FDI, i.e. investment that makes a maximum contribution to economic, social and environmental development and takes place within mutually beneficial governance mechanisms while being commercially viable.

² Ibid.

³ Ibid.

⁴ CFIUS, *Annual Report to Congress, Report Period CY2010* (Washington, DC: CFIUS, 2011).

- Governments pay more attention to competing objectives, especially national interests/essential security, the promotion of national champions and the protection of national industries.
- Pressure from civil society.
- The growth of FDI from emerging markets brings new players into the global FDI market, and their competition is not welcome by all, especially if they are SCEs.
- The cumulative number of treaty-based investment disputes brought by firms rose from 38 in 1999 to 450 in 2011, involving 89 governments.⁵ Importantly, a number of developed countries have become respondents and therefore seek to protect themselves against far-reaching interpretations of international investment law and from losing arbitrations (even if that means weakening important elements of BIT protections).
- Finally, it is unclear how important BITs are to help attract FDI, while it is clear that they restrict the policy space of governments.

What does all this add up to? For all governments, FDI is a tool. To the extent it serves their objectives, it will be promoted or restricted. We are thus moving toward a regulatory approach that is more protective of sovereigns by allowing more policy space for governments to regulate FDI in the public interest, at the national and international levels. This is being helped by the fact that more and more countries are simultaneously home and host countries.

Rebalancing the investment regime to take into account the interests of both host countries and investors is a welcome development as it strengthens the regime's legitimacy and puts the relations between governments and MNEs on a more solid footing. The challenge is to find the right balance between the rights and responsibilities of governments and MNEs -- a challenge central to the future of the investment regime.

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⁵ UNCTAD, *IIA Issues Note*, no. 1, 2012.

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