National Security Paradigms in the Regulation of Foreign Investments: Assessing Trends in the United States, Europe, and Japan

Saadia M. Pekkanen
Job and Gertrud Tamaki Professor, School of International Studies
Adjunct Professor, School of Law
University of Washington
Box 353650
Seattle, WA 98195-3650
Tel: (206) 543-6148
Fax: (206) 685-0668
smp1@u.washington.edu

Paper for presentation at the Asian International Economic Law Network (AIELN) Inaugural conference, University of Tokyo, Tokyo, Japan, 3 August 2009.

Not for citation or circulation

(Total word count: 5,992)

National Security Paradigms in the Regulation of Foreign Investments: Assessing Trends in the United States, Europe, and Japan

Saadia M. Pekkanen

Since the late 1990s there has been significant interest in the governance of investments in the international economic system for a singular reason. In contrast to the multilateral governance of international trade flows through the World Trade Organization (WTO), perhaps the most remarkable feature about international investments is that there is no equivalent comprehensive multilateral governance in place. To be sure, efforts have been made through both the Organization of Economic Cooperation and Development (OECD), as well as the WTO to advance exactly such governance. But to little avail. To this day, the governance of investments worldwide continues to take place through a hybrid and overlapping system comprising national laws and regulations, as well as preferential, plurilateral, or sector-specific agreements, and increasingly prominent, bilateral investment treaties (BITs). Rather than a concerted focus at the multilateral system, therefore, investment-related governance structures are principally and increasingly being shaped by these non-multilateral structures through which, it is generally thought, governments can direct greater control over the pace and contents of investment flows across borders.

This paper examines the structure of governance in global investment, with the goal of seeing whether we can speak of a “national security” paradigm that could affect cross-border operations particularly among dominant players such as the United States, Europe, and Japan. It is in four parts. The first part makes clear the players and motivations that continue to shape governance in investments worldwide. The second part lays out the actual investment realities at both the aggregate and sectoral levels involving the US, Europe, and Japan. The third part then turns to an investigation especially of the ways (a) multilateral, (b) preferential, bilateral, and plurilateral, and (c) national efforts have been used to govern and regulate investments across borders with a national security paradigm in mind.

Players and Motivations

From virtually the inception of postwar investments it was the protection of investors' rights, rather than economic development or technological advancement of developing countries per se, that became the most pivotal and also most controversial element in the governance of investments.[1] This has been true irrespective of whether such protections – normally acquired through binding international legal instruments as a possible filler for inadequate domestic laws and institutions especially in developing and emerging economies – have actually increased foreign direct investment (FDI) to developing countries or not.[2]

Even as issues such as increases in FDI and advances in economic development continue to generate controversy, legal structures continued to be put in motion to secure investors' rights across borders in piecemeal fashion. Today there is little question the world has come a long way in governance standards from the relevant rule of customary international law, namely the "Hull Rule" which required "prompt, adequate and effective" compensation in the case of expropriations. But as in the early postwar period, so now, the principal object of concern remains less the development prospects based on FDI and more the protection of the investors

---

[1] Andrew T. Guzman, "Why Do LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties," *Virginia Journal of International Law* 38(4), 1998, pp. 639-689.

[2] For an overview, see Eric Neumayer and Laura Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?," *World Development* 33(10), pp. 1567-1585, 2005; and also Zachary Elkins, Andrew T. Guzman, and Beth A. Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000," *International Organization* 60(3), pp. 811-846.

themselves as they spread beyond the advanced industrial countries to the fast rising economies in the developing world, especially in Asia.

Understanding the interests of the actual investors, then, allows us to bring a semblance of coherence to rapidly proliferating investment agreements and regulations involving the US, Europe, and Japan. At a pragmatic level, what motivates investors? Like all actors that find themselves enmeshed in economic transactions across borders, they seek a credible legal framework that helps to guarantee their their property rights in the broader sense and, in turn, brings a measure of calculability and predictability necessary to the success of their continued operations across borders.[3] Both public and private actors thus have a stake in ensuring the protection of investments not just in terms of litigation but also in terms of the very rules on which that litigation turns. Whether through multilateral, bilateral, or national means, legal instruments thus become the most legitimate and efficient method for all actors to attempt to turn outcomes in their favor. For governments operating in the domestic political marketplace, especially in the advanced industrial democracies, the goal is not just to answer corporate calls for providing exactly such legal protections across the global economy. It is also to ensure that they retain a sovereign role in the construction and implementation of such legal instruments. At the national level, which thus also emerges as a significant source in shaping cross-border investments, governments in Europe, Japan and especially the US have also used domestic laws and regulations to jealously guard their national economic security by curtailing operations that cross over into their sovereign territorial boundaries.

---

[3] Kanishka Jayasuriya, "Introduction: A Framework for the Analysis of Legal Institutions in East Asia," in *Law, Capitalism and Power in Asia: The Rule of Law and Legal Institutions*, edited by K. Jayasuriya (London: Routledge, 1999), pp. 5-6; Gregory C. Shaffer, *Defending Interests: Public-Private Partnerships in WTO Litigation*. (Washington, D.C.: Brookings Institution Press, 2003), esp. p. 17; Miles Kahler, "Legalization as Strategy: The Asia-Pacific Case," *International Organization* 54 (3), 2000, pp. 559-560; and Saadia M. Pekkanen, *Japan's Aggressive Legalism: Law and Foreign Trade Politics Beyond the WTO* (Stanford, CA: Stanford University Press, 2008), pp. 2-4.

Global Investment Realities

As is widely appreciated, both inward and outward foreign direct investment (FDI) has been the driving forces behind globalization irrespective of whether they are going up and down in trends. Given the financial and credit turmoil in the world at present, global FDI growth is projected to decline at least 10 percent or so in the short term.[4] However, this is unlikely to mean that global patterns will change drastically especially in terms of origins, concentrations, and contents of FDI flows and stocks. Rather, as projections suggest, it is far more probable that the size or levels of cross-border FDI flows will contract markedly. But what exactly are the existing patterns on global FDI? Before approaching governance issues regarding investments, it is helpful to begin with a clear understanding of the actual patterns.

In 2007, inward FDI levels accounted for about US$1.8 trillion, and rose across all developed and developing countries alike.[5] Despite the long-touted importance of FDI inflows for economic development purposes, the fact continues to remain that of the total amount of inward FDI in 2007, developed economies garnered approximately 68 percent of all such inflows. Within these aggregate figures, the regional and country patterns are also instructive. As a region Europe, including the 25 European Union (EU) members, accounts for a hefty 46 percent of global FDI inflows altogether. Within the EU, the member country that stands out above others is the UK which, as a single country, took in about 12.2 percent of all global inward FDI flows. As a rough comparison, among the next big recipient countries France stood at about 8.6 percent, the Netherlands at 5.4 percent, and Germany at a mere 2.8 percent. In terms of the other

[4] United Nations Conference on Trade and Development (UNCTAD), "Foreign Direct Investment May Have Peaked in 2007, Annual Report Reveals," Press Release, UNCTAD/PRESS/PR/2008/028/Rev.1, 24 September 2008.
[5] Unless otherwise indicated, investment-related facts in this section are from UNCTAD, *World Investment Report 2008* (New York and Geneva: United Nations, 2008), esp. Figure 1.23, Annex Table A.I.2, Annex Table A.I.5, Annex Table A.I.7, Annex Table A.I.8, Annex Table A.I.11, Annex Table A.I.5, Annex Table B.1, Annex Table B.2., and pp. 22-33; and UNCTAD, "Foreign Direct Investment Reached New Record in 2007," Press Release, UNCTAD/PRESS/PR/2008/001, 8 January 2008. Additional information is from the official website of the Sovereign Wealth Fund Institute, available online at www.swfinstitute.org (accessed 20 November 2008).

dominant players under study, the US, as the world's single largest economy accounted for about 12.7% of all global inward FDI. Thus far, it holds the distinction of being also the single largest FDI recipient country though this lead is no longer commanding in any sense in comparison to European countries such as the UK. Meanwhile, in a pattern long notable among advanced industrial countries over the postwar period, Japan, the world's second largest economy, only received a paltry 1.2 percent of the same global inward FDI flows.

These are also some of the main countries and regions that stand out in terms of outward FDI flows. As with inflows, developed countries dominate global investment patterns as a source of FDI. In 2007, they accounted for a whopping 84.8 percent of all global outward FDI. As a region, Europe stood out once again as well, serving as a source for about 61 percent of all outward global FDI. Of the EU member countries, the UK accounts for 13.3 percent, followed by France at 11.3 percent, and Germany at 8.4 percent. For the other dominant economic powers in the analysis, the US emerged as the single largest source of outward FDI at about 16 percent of the world total. Japan again lagged considerably behind the other developed countries, accounting for only 3.7 percent of all global outward FDI.

To summarize briefly, both the EU as well as the US are dominant players in global FDI patterns. Relative to them, Japan is not a significant player in terms of outward and especially inward FDI. It is also important to note that although the investment patterns above are for FDI flows, a similar story emerges about FDI stock by region and country. In 2007, as a single country, the US was dominant above all other countries in terms of inward and outward FDI stock levels. Within the EU, which towered over all other regions and countries, the UK, France, and then Germany emerged as the top contenders. Japan, in comparison, was considerably behind on both fronts, with aggregate outward and inward stock figures that put it more in the range of the second-tier of EU countries such as Italy, Netherlands, Spain, and Sweden than the top tier countries. Importantly also, in 2007, it was the United Kingdom and the United States that remained the top two preferred locations for foreign affiliates of the top transnational corporations. In the same ranking, Germany came in third, and Japan was ranked nineteenth.

Global Governance of Investments

As stated at the outset, there is no center of gravity regarding the governance of international investments. Rather, for the most part, the international investment flows discussed above continue to be governed by a hybrid set of regulations and laws that determine the pace, contents, and terms which affect the actions of both governmental and corporate actors.[6] This section lays out a brief overview of the governance structures to date that take us from the multilateral level through preferential, bilateral, and plurilateral instruments, and down to specific national regulations and laws especially in the US, Europe, and Japan that may have begun to speak more to concerns with a national security paradigm in mind.

Multilateral

The departure point for understanding the governance structure of investment is that it has certainly had a long history at the global multilateral level. But while significant steps have been taken at various junctures over the postwar period in that direction, little has come to actual fruition in terms of the protections of private investment as a comprehensive single body of international law. In 1948, Article 12 of the charter of the International Trade Organization (ITO)

---

[6] For a concise overview of the present and future of investment treaties, see Raul R. Herrera, "Global Trends in Investment Treaties and Investor-State Arbitration (Arnold & Porter LLP)," Presentation at the FIESP/ABCI Institute Conference on "Revising Bilateral Investment Treaties," 25 September 2008, pp. 1-15; and also Jean E. Kalicki, "Investment Treaties: Key Provisions and Their 'Next Generation' (Arnold & Porter LLP), Presentation at the FIESP/ABCI Institute Conference on "Revising Bilateral Investment Treaties," 25 September 2008, pp. 1-20.

focused specifically on the "International Investment for Economic Development and Reconstruction."[7] Although the ITO itself was never born, it is instructive that Article 12 at least sought to provide a basis for a comprehensive code for both public and private investment, with attention to balancing protections for the investors with sovereign concerns. In 1949, the International Chamber of Commerce issued a draft code for protecting investments worldwide; and by 1957 it was still calling to construct a viable convention based on the earlier draft code in conjunction with ECOSOC, the International Bank for Reconstruction and Development, and the International Finance Corporation.[8]

Other notable early efforts included the "International Convention for the Mutual Protection of Private Property Rights in Foreign Countries," which was also an actual draft code published in 1957 by business interests in West Germany through the Society to Advance the Protections of Foreign Investments. The German society code showed a particular emphasis on investors' rights through three essential points – the protection of business activities of foreign investors, the establishment of international tribunals for resolving disputes, and the enforcement of the code through sanctions. These points only served to highlight differences among the different objectives of actors in the capital-exporting (developed) and capital-importing (developing) countries of the time, and still continue to be relevant today: Would foreign investment harm or promote the industrially backward countries? Might it strengthen the strategic, political, and economic hand of the more developed countries?

What was true of such conflicts between developed and developing countries over the protections of foreign investment within sovereign borders then continues to mar the progress of

[7] See United Nations Conference on Trade and Employment (held at Havana, Cuba from 21 November 1947 to 24 March 1948), Final Act and Related Documents, Interim Commission for the International Trade Organization, Lake Success, New York, April 1948.
[8] For the early historical background, see Arthur S. Miller, "Protection of Private Foreign Investment by Multilateral Convention," *American Journal of International Law* 53(2) 1959, pp. 371-378.

a comprehensive general multilateral code even today. To be sure some progress has been made through the WTO in the form of the Agreement on Trade-Related Investment Measures (TRIMs), which is one of several appended to the General Agreement on Tariffs and Trade (GATT) 1994. But this is a rudimentary agreement, whose opening article makes clear that it extends only to trade in goods; and whose preamble as well as contents shows a focus on investment measures that can cause restrictive, distorting, and adverse effects on the flow of trade in terms of exports and imports rather than on the protection of investment within sovereign borders per se.[9] In contrast, with respect to trade in services, one of the four modes in the General Agreement on Trade in Services (GATS) identifies the supply of services through "commercial presence" in the territory of another member, which is taken to mean direct investment in services such as branches of financial institutions.[10] That there is no comparable provision for direct investment in goods is what continues to be of concern to private investors.

To date, there has been no further progress in terms of negotiations over generally applicable rules within key international institutions such as the WTO or the Organization of Economic Cooperation and Development (OECD). Under the auspices of the OECD, negotiations actually preceded those at the WTO.[11] In an effort to provide comprehensive standards for the treatment, protection, and liberalization of investment, negotiations for a

---

[9] See WTO, Agreement on Trade-Related Investment Measures, Articles 1-9.
[10] See WTO, General Agreement on Trade in Services, Article I.2.c.
[11] On investment issues in the OECD see: OECD DAFFE/CMIT/CIME(95)13/FINAL, *A Multilateral Agreement on Investment – Report by the Committee on International Investment and Multinational Enterprises (CIME)/ and the Committee on Capital Movements and Invisible Transactions (CMIT)*, 5 May 1995; OECD DAFFE/MAI(98)7/Rev1, *The Multilateral Agreement on Investment – Draft Consolidated Text* , 22 April 1998; OECD, *Ministerial Statement on the Multilateral Agreement on Investment (MAI)*, 28th April 1998*;* "OECD Talks on MAI Officially End," *Bridges Weekly Trade News Digest* 2(48), 14 December 1998;. On investment issues in the WTO see: WTO WT/Min(96)/DEC, *Ministerial Declaration – Adopted on 13 December 1996*, Singapore, 18 December 1996; WTO WT/MIN(01)/DEC/1, *Ministerial Declaration – Adopted on 14 November 2001*, Doha, 20 November 2001; WTO WT/Min(03)/20, *Ministerial Statement – Adopted on 14 September 2003*, Cancun, 23 September 2003; WTO WT/L/579, *Doha Work Programme: Decision Adopted by the General Council on 1 August 2004*, 2 August 2004, 3; "WTO Members Fail to Make Progress at Mini-Ministerial," *Bridges Weekly Trade News Digest* 7(23), 1-2. For an earlier discussion of the floundering of investment issues at the multilateral levels see Saadia M. Pekkanen, *Japan's Aggressive Legalism*, pp. 228-230.

Multilateral Agreement on Investment (MAI) got underway in 1995. Eventually there was a draft text, but an actual treaty failed to emerge due to criticisms by civil society groups, increasing disinterest by the OECD governments, and eventual apathy on the part also of dominant business groups. By the end of 1998, negotiations over MAI were abandoned all around. The WTO followed a similar path, which also led to a similar outcome. In 1996, a Ministerial Declaration focused on trade and investment as part of the so-called Singapore issues quartet (along with competition policy, government procurement, and trade facilitation). But as negotiations proceeded the interests of the developed and developing world clashed strongly over the protections needed for cross-border investments. By 2004, the WTO General Council adopted a decision, categorically stating that no negotiations or work on the investment (along with competition policy and government procurement) issue would take place during the then ongoing Doha Round.

Perhaps the most important example of a multilateral investment treaty is actually a sector-specific one, namely the 1994 Energy Charter Treaty (ECT) which entered into force in 1998.[12] This treaty, as the name suggests, is designed to facilitate and promote cooperation in the energy sector. While certainly mindful of concerns such as sovereignty over energy resources as well as their environmental impacts, the provisions and history of the ECT leave little doubt that it is designed to promote a stable milieu for investors and their investments.[13] As of May 2007, 48 Charter signatories, including Germany, the United Kingdom, and Japan, had deposited instruments of ratification, with another five members having signed up. Significantly, the US is

[12] The information and details on the ECT is from the official website, available online at www.encharter.org (accessed 20 November 2008); and more specifically from Energy Charter Secretariat, T*he Energy Charter Treaty and Related Documents: A Legal Framework for International Energy Cooperation* (Brussels, Belgium: Energy Charter Secretariat, 2004).

[13] The ECT has taken steps toward formulating clear policy aims and good practices related to increasing energy efficiency and decreasing environmental harm with the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) which entered into force at the same time as the ECT in 1998.

not a signatory to the ECT; however, along with 55 other countries, it is a signatory to the 1991 Energy Charter Declaration (also known as the European Energy Charter) that provides the political foundation for the ECT process and that is considered a prerequisite for accession to the 1994 ECT. The ECT establishes both state-state and investor-state dispute settlement provisions, and as of 2008 had a reported twenty cases that were brought by investors to international arbitration. Certainly, increasing awareness of the treaty may well allow it to become a more well-known part and parcel of the overall global governance structure in investment. But, at the moment, the most striking aspect of the ECT is that, with the exception of Japan, Turkey, and some Central Asian states, it remains a governing instrument largely by and for Western and Eastern European countries, who constitute the overwhelming majority of its signatories.

Preferential, Bilateral, and Plurilateral

Given the stakes for corporate actors worldwide, it is not a surprise that the search for effective general legal protections for investment continues. The fact is that this search has been resurrected as a "WTO-Plus" issue, and interest in negotiating rules for it have shifted from multilateral forums to preferential, bilateral, and plurilateral forums where governments, especially advanced industrial ones in the US, Japan, and Europe have more control over the outcomes.[14] Instead of the multilateral route, much of the progress over the governance in investment has come in a patchwork form: investment-related chapters in preferential trade

[14] On the issue of control over outcomes across international forums, see Saadia M. Pekkanen, Mireya Solis, and Saori N. Katada, "Trading Gains for Control: International Trade Forums and Japanese Economic Diplomacy." *International Studies Quarterly* 51(4), 2007, pp. 945-970.

agreements (PTAs), a burgeoning set of bilateral investment treaties (BITs), and also explicit moves toward plurilateral treaties that are not as well known.[15] These are taken up in turn below.

In terms of PTAs, the worldwide move toward negotiating free trade and other economic partnership agreements is now well known. WTO estimates suggest that approximately 400 such agreements will be implemented by 2010. What is less well-known is that unlike the past, most of the newer agreements also have chapters that specify the principles and scope of investments, as well as the obligations of governments and investors with respect to each other in the case of related disputes. Although there continue to be controversies about convergence between the provisions of such chapters and actual BITs, discussed below, investment-related chapters constitute a a trend that is not likely to disappear. Among the most well-known of such provisions is Chapter 11 (Investment) of the North American Free Trade Agreement (NAFTA), which sets up standards of treatment as well as investor-state arbitration procedures in the matter of dispute settlement between the signing parties, namely the United States, Canada, and Mexico.[16] Although not uniformly so, there is partial merit to the claim that it is now becoming common practice for the US to include investment chapters in its newer PTAs based on its model 2004 BIT. As elsewhere, the presence of such chapters obviates the need for the US to conclude separate BITs and vice versa as, for example, in the case of the US-Jordan FTA signed in 2001 which does not contain investment provisions in light of the pre-existing US-Jordan BIT signed in 1997.[17]

---

[15] Unless otherwise indicated in this section, general information on country-based trade agreements is taken from those reported to under the WTO gateway to "Regional Trade Agreements," available online at www.wto.org (accessed 20 November 2008); information and details on country-based BITs are from those available online through UNCTAD, "Investment Instruments Online," available online at www.unctadxi.org (accessed 20 November 2008).

[16] NAFTA, Chapter Eleven (Investment), §1101-1139.

[17] Chang-fa Lo, "A Comparison of BIT and the Investment Chapter of Free Trade Agreements from Policy Perspective," *Asian Journal of WTO & International Health Law and Policy*, 3(1), 2008, pp. 153-154, 165-168. For the text of the US-Jordan FTA, see *The Agreement Between the United States of America and the Hashemite*

In Europe, there are also similar trends.[18] The 1960 Stockholm Convention establishing the European Free Trade Association (EFTA) did not have an investment chapter until it was updated by the Vaduz Convention signed in 2001. As for external agreements signed by EFTA, such as with Morocco in 1997 and later Egypt in 2007, broad investment provisions related to conditions and promotion are folded into its general Free Trade Agreements (FTAs). The EC has also concluded some trade agreements, such as with Israel in 1995 and Jordan in 1997, that contain provisions liberalizing the flow of capital among the parties; others such as the more recent one signed with Mexico in 2000 on trade in goods do not contain investment provisions. Compared to both the US and Europe, Japan's now almost decade-old preferential trade diplomacy has moved in a far more integrated fashion with respect to the protection of investments.[19] Starting from its economic partnership agreements with Singapore in 2002 and Mexico in 2004, and moving onto BITs, the country's agreements include clear provisions dealing with dispute settlement involving host states and foreign states, host states and foreign investors, as well as host judiciaries and foreign investors.

Kingdom of Jordan on the Establishment of a Free Trade Area, available online at www.ustr.gov (accessed 20 November 2008).

[18] Information on the history and trade agreements of EFTA is from the official website at www.efta.int (accessed 19 November 2008). For the text of the agreements therein see *Agreement Between the EFTA States and the Hashemite Kingdom of Jordan*, and *Free Trade Agreement Between the Arab Republic of Egypt and the EFTA States*. Information on the text of the EU agreements is from WTO, WT/REG110/1, *Euro-Mediterranean Agreement Establishing an Association Between the European Communities and their Member States, Of the One Part, and the State of Israel, Of the Other Part*, 7 November 2000; and WTO, WT/REG141/1, *Euro-Mediterranean Agreement Establishing an Association Between the European Communities and Their Members States, Of the One Part, and the Hashemite Kingdom of Jordan, Of the Other Part*, 24 December 2002. Additional information on these two agreements, as well as on Mexico, is from the factual abstracts under the Transparency Mechanisms for RTAs in the WTO, available online at www.wto.int (accessed 20 November 2008); and other background information on bilateral external trade relations is from the official website of the European Commission available online at ec.europa.eu (accessed 20 November 2008).

[19] On Japan's investment agenda through both EPAs and BITs, see Saadia M. Pekkanen, *Japan's Aggressive Legalism*, pp. 262-263.

Perhaps the most well-known phenomenon at present in the governance of investments are actually the BITs themselves.[20] Starting in the late 1990s, there has been a rapid proliferation of BITs worldwide though they are now being signed at a slower rate at the close of the 2000s. At the end of 2007, there were an estimated total number of 2,608 BITs already signed; and Germany, China, Switzerland, and the UK held the top four spots as signatories of BITs worldwide. Not surprisingly, developed countries accounted for about 60 percent of all BITs signed by the end of 2007 as well. With respect to the governments under study here, as of June 2008, Germany had signed 136 BITs, the UK 103 BITs, the US 47 BITs, and Japan a mere 12 BITs. As close to 40 percent of all BITs signed at the end of 2007 were between developed and developing countries, it is not a surprise that almost all the BITs concluded by Germany, the UK, the US, and Japan to date have also been with developing or emerging economies.

At this stage it is helpful to take stock also of what the presence of all these legal instruments mean for the actual protection of state interests and investors' rights. There is considerable evidence to suggest that they matter very concretely both for states interested in preserving their sovereign economic security and for corporations concerned with protecting their investments across borders.[21] This is reflected in the number of disputes arising under the legal instruments described above. Between 1987 and 2007, there were close to 300 cumulative treaty-based dispute cases, and more than 60 percent of them were filed with the International

[20] The background details and information on BITs is from UNCTAD, *Recent Developments in International Investment Agreements (2007-June 2008)*, IIA Monitor No. 2 (2008) International Investment Agreements, UNCTAD/WEB/DIAE/IA/2009/1 (New York and Geneva: United Nations, 2008), pp. 2-5; and UNCTAD, *Quantitative Data on Bilateral Investment Treaties and Double Taxation Treaties*, document available online at www.unctad.org (accessed 20 November 2008).

[21] UNCTAD, *Latest Developments in Investor-State Dispute Settlement, IIA Monitor No. 1 (2008), International Investment Agreements*, UNCTAD/WEB/ITE/IIA/2008/3 (Geneva: UNCTAD, 2008), pp. 1-3, Annex 1.

Center for Settlement of Investment Disputes (ICSID, or ICSID Additional Facility).[22] Approximately 78 percent of them resulted from violations of BIT provisions, 13 percent from NAFTA violations, and 6 percent from the ECT. In 2007, there were also the first two cases to arise under the Central America-Dominican Republic-United States Free Trade agreement (CAFTA-DR). What kinds of investors were involved across these cases? About 40 percent of the cases involved the services sector, which included electricity distribution, telecommunications, debt instruments, water services and waste management. Another 30 percent involved the manufacturing sector, followed by about 25 percent in the primary sector. Who also were the main governments involved? It appears that about half the investment treaty arbitrations during this period targeted developing countries, with Argentina and Mexico topping the list followed at some distance by the Czech Republic, Canada, and the United States. Yet it is important that of the known awards rendered in 2007, 42 cases were decided in favor of states, 40 cases were decided in favor of investors, and 37 cases were settled amicably.

Finally, there is a concerted plurilateral effort underway in Asia that, if it comes to fruition, will reverberate outward to affect both other regional as well as bilateral investment instruments across the globe. This involves the slow but nevertheless ongoing negotiations over a China-Japan-Korea (CJK) investment treaty, which have not attracted much attention thus far.[23] Several indicators suggest the seriousness with which Japanese investors in particular take the protection of their investment in the Asian region, and the ways in which the Japanese

---

[22] As a relative benchmark, about 28 percent of the disputes were also filed under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), 5 percent at the Stockholm Chamber of Commerce (SCC), 2 percent at the International Chamber of Commerce, and 2 percent through ad hoc arbitration.

[23] The following discussion draws on Saadia M. Pekkanen, *Japan's Aggressive Legalism*, pp. 270-271. The information on the CJK treaty is also updated through Correspondence, METI Official, Tokyo, Japan, 1 April 2008; Correspondence, METI Official, Tokyo, Japan, 13 November 2008; Correspondence, METI Official, Tokyo, Japan, 19 November 2008.

government has responded concretely with attempts to construct rule-based protections.[24] In November 1999, Japan, China and Korea used a trilateral summit meeting in the Philippines to discuss the possibilities of stronger economic cooperation, which is a modest objective that is endorsed annually. While China and Korea have shown interest in moving forward with a broad trilateral FTA, Japan is most interested in the establishment of a narrow trilateral CJK investment treaty. In some ways, this is unsurprising, as Japan is the second largest foreign investor in China and the third largest one in Korea, and official studies all suggest that there is far greater FDI potential in both countries for Japanese businesses.

In October 2003, China, Japan and Korea issued a joint declaration on the promotion of tripartite cooperation, with one of the fourteen focus areas including direct investment. The three governments then launched an informal joint study group to explore the possibilities of a more formal investment pact among the three countries. The study groups have turned into formal rounds of negotiations. In November 2006, the tripartite investment negotiations began in earnest. Starting in 2007, the pace picked up with successive trilateral investment agreement negotiation rounds – the first in March, the second in July/August, and the third in November. As of 2008, two further negotiating rounds were added – the fourth in March, and the fifth in November. Since a CJK investment treaty is seen as a critical step to a formal trilateral FTA as well, work on it has progressed beyond rhetoric to actual contestation over specific provisions such as pre-establishment national treatment.

---

[24] See the official documents: *Trilateral Meeting of the Leader's of Japan, the People's Republic of China and the Republic of Korea (ROK) (summary)*, esp. ¶1.1; *The Progress Report of the Trilateral Cooperation Among the People's Republic of China, Japan and the Republic of Korea*, Adopted on November 27, 2004 by the Three-Party Committee in Vientiane, the Lao PDR, ¶1 (Direct Investment); and *The Action Strategy on Trilateral Cooperation Among the People's Republic of China, Japan and the Republic of Korea*, Adopted on 27 November 2004 by the Three-Party Committee; with all documents available online at www.mofa.go.jp (accessed 20 November 2008); *The Report of the Joint Study Group on the Possible Trilateral Investment Arrangements Among China, Japan, and Korea*, available online at www.meti.go.jp (accessed 20 November 2008), 3-5; Cabinet Office, Government of Japan, *Trade and Investment Liberalization Among China, Japan and Korea – China's WTO Accession and Regional Integration in Northeast Asia*, 20 December 2001, 32-41

National

Regulations by sovereign governments and entities also constitute some of the most significant sources of governance of foreign investments, often with considerations of national security, that while ambiguous, as a concept nevertheless remains potent in the realm of regulations. This section highlights the principal measures that unite and distinguish the players under study here to regulate cross-border investments – namely the US that has had well-known and now updated measures to dealing with foreign investments with an eye on national security; Europe that does not have coherent measures as a collective entity but whose member states, such as Germany and the UK, do so with respect to strategic sectors in the interest of national security; and Japan that is increasingly aggressive in using domestic acts and judicial institutions to affect outcomes in cross-border investments also slanted in the national security direction.[25]

United States

The US has had a long-standing administrative structure related to the regulation of inward FDI, beginning most visibly in 1975 with the creation of the Committee on Foreign Investment in the United States (CFIUS).[26] CFIUS is an interagency committee that has

[25] For some of the background information on the historical and contemporary regulation across jurisdictions, this section relies on Ha-Joon Chang, "Foreign Investment Regulation in Historical Perspective – Lessons for the Proposed WT) Agreement on Investment," Manuscript, Faculty of Economics and Politics, University of Cambridge, March 2003, pp. 1-3; Ha-Joon Chang and Duncan Green, *The Northern WTO Agenda on Investment: Do As we Say, Not As We Did* (Geneva: South Centre, June 2003), pp. 1-60; and United States Government Accountability Office (USGAO), *Foreign Investment: Laws and Policies Regulation Foreign Investment in 10 Countries*, GAO-08-320 (Washington, DC: GAO, February 2008), esp. Appendix VII (Germany), Appendix IX (Japan), and Appendix XIII (United Kingdom).

[26] The background information and details on the US are also from the following sources: James K. Jackson, "The Committee on Foreign Investment in the United States (CFIUS)," Congressional Research Service (CRS) Report for Congress, RL33388, 8 April 2008, pp. 1-23; James K. Jackson, "Foreign Investment, CFIUS, and Homeland Security: An Overview," CRS Report for Congress, RS22863, 17 April 2008, pp 1-6; James K. Jackson, "The Exon-Florio National Security Test for Foreign Investment," CRS Report for Congress, RS22197, 23 February 2006, pp. 1-6; USGAO, *Foreign Investment: Laws and Policies Regulation Foreign Investment in 10 Countries*, pp. 6-7, Appendix III; and Edward M. Graham and David M. Marchick, *US National Security and Foreign Direct Investment* (Washington, DC: Institute for International Economics, 2006), pp. 29-30, 33-73, 95-96.

remained largely obscure and deliberately silent in terms of its operations given the confidential nature of reviews of proposed transactions. One estimate suggests that CFIUS has received more than 1,500 notifications; of those, it has fully investigated 25 cases. Within these 25 cases, 13 have been withdrawn upon notice that CFIUS would conduct a review, and twelve were sent to the President. Of these twelve, one was prohibited. On a yearly basis in 2006 CFIUS received 113 notices, which was about 6.5 percent of the total transactions of foreign companies acquiring US companies; seven of those proceeded to full investigations and none were prohibited. In 2007, CFIUS received 147 notices, of which six proceeded to full investigations and none also were prohibited. The fact is, according to the Treasury Department which is the lead agency, historically less than 10 percent of FDI in US companies have been reviewed by CFIUS. More recently CFIUS has come under public scrutiny, given the widespread furor over a few inward investments that have made recent headline news especially in the aftermath of 9/11 and the fact of rising rivals – the sale of IBM's personal computer division to a Chinese company, China National Offshore Oil Corporation's (CNOOC) proposed acquisition of Unocal Oil Company, and Dubai Ports World proposed acquisition of P&O for commercial port operations in six US ports. Whether right or wrong, the combined impact of these highly publicized proposed foreign investments in the US had the effect of once again highlighting the historical US tendency to impose restrictions on FDI in times of conflict or insecurity.

Perhaps the most well-known evidence of such tendencies came to the fore in the late 1980s, when there was tremendous concern about Japanese acquisitions in the US. In 1988, the US Congress enacted the Exon-Florio Amendment to Section 721 of the Defense Production Act of 1950. Essentially an investment review, the Exon-Florio Amendment authorizes the president to investigate foreign acquisitions, mergers, and takeovers, or direct investments in US companies from the perspective of national security; if necessary to preserving national security, the President may prohibit any such transactions. At the time Exon-Florio became law, the President delegated his initial review and investigative responsibilities to CFIUS. In 1993, the Byrd Amendment to the National Defense Authorization Act amended Exon-Florio to mandate an investigation into any merger, acquisition, or takeover activity when two criteria were met – foreign government ownership is involved and US national security could be affected. It was this amendment that came under scrutiny in the debacle over Dubai Ports World in which, briefly put, CFIUS concluded during its initial 30-day review that the transaction could not affect national security.

In the aftermath of that event, in which CFIUS's conclusions became highly politicized, the Bush Administration began to require foreign investors to agree to Special Security Arrangements (SSA) that restrict foreign investor's access to sensitive technologies of US companies in the event that the such foreign investors are authorized to acquire a US company. Under this new change, CFIUS reviews are never final; and CFIUS can overturn its approval down the line in cases where the companies materially fail to comply with the SSA. In July 2007, the US Congress changed the review of FDI when it adopted and the President signed P.L. 110-49, the Foreign Investment and National Security Act of 2007 (FINSA). Through it, the US Congress strengthened its own role by improving its oversight capabilities (greater reporting by CFIUS) and also altered the meaning of national security in the Exon-Florio provision (inclusion of critical infrastructure and homeland security as separately identifiable components of national security).

Europe

The point of departure for understanding European measures is that FDI does not fall quite under the EU's Common Commercial Policy.[27] For this reason the European Commission, as the executive branch of the EU, has long been in conflict with Member States about responsibility for governing FDI, such as through the authority to conclude international investment agreements. Historically, the balance of power over FDI lies with the Member States, and the European Community has very limited legal authority in the form of non-exclusive competency over investment; this is all the more significant since the European Court of Justice (ECJ) has also weighed in that investment agreements with third countries are primarily the preserve of Member States. Under the new Reform Treaty, (the EU Constitution's successor as the latter was abandoned in 2005), there continues to be a great deal of confusion as the Treaty brings FDI under the EUs Common Commercial Policy but adds that this does not change legal competencies. At this stage then, investment regulations are very much the national prerogative of Member States, and both Germany and the United Kingdom are discussed below.

Although the German government does not restrict foreign investments, it has made some recent changes. In 2004, it enacted Section 7 of the German Foreign Trade and Payments Act which restricts investments for the maintenance of essential security and external interests. The implementing regulations clarify that any foreign acquisition or participation triggers a review in the cases of those German companies which operate, for the most part, in sectors designated in the country's War Weapons Control Act. In 2008, the German government also moved to

[27] The background information and details on Europe are also from the following sources: Damon Vis-Dunbar, "European Treaty May Revive Debates Over Power to Conclude Investment Agreements," Investment Treaty News (International Institute for Sustainable Development), 30 October 2007, available online at www.investmenttreatynews.com (accessed 20 November 2008); and "Germany Approves Law Against Some Foreign Investors," The Associated Press, 20 August 2008, available online at www.bilaterals.org (accessed 20 November 2008).

approve a law to block moves especially by SWFs (or state-controlled foreign funds) with interest in acquiring large stakes in German companies that could endanger the country's interests. In the United Kingdom, there is no specific legal framework to govern direct investments for national security reasons. There are, however, several sources that allow the government to block transactions that may be inimical to UK national interests. These include the 1990 European Merger Regulation, which affects intervention in mergers and acqusitions; the 1975 Industry Act, which authorizes intervention if non-residents acquire manufacturing concerns that contravene national interest but which has never been used to date; and the 2002 Enterprise Act which authorizes broad special interventions, blockages, or restrictions on mergers and acquisitions involving UK companies that contravene the public interest (typically, but not always, involving competition or anti-trust concerns associated with mergers).The Enterprise Act also authorizes interventions in mergers involving UK government contractors in the possession of defense-related or confidential information.

Japan

As pointed out earlier, Japan stands out for the paucity of incoming FDI flows in comparison to the other advanced industrial democracies.[28] Japan has followed a selective and highly circumspect approach to liberalization since joining the OECD (1967-1980), and comparative figures can only speak to the "success" of that approach: inward FDI as a share of GNP in 2000 stood at 30.5 percent in the UK, 24.1 percent in Germany, 12.4 percent in the US

---

[28] The background information and details on Japan are also from the following sources: Kyoji Fukao and Tomofumi Amano, "Foreign Direct Investment and the Japanese Economy: Key to Japan's Revitalization," Fukao Report, 29 October 2003, pp. 1-22, available online at www.rieti.go.jp (accessed 20 November 2008); Ulrike Schaede, *Choose and Focus: Japanese Business Strategies for the 21st Century* (Ithaca, NY: Cornell University Press, 2008), pp. 110-133; and Colin P.A. Jones, "Sovereign Immunity – Commercial Activity – Suit for Contractual Damages," *American Journal of International Law* 100(4), 2006, pp. 908-910; and Correspondence, Attorney-at-Law, Tokyo, Japan, 4 February 2008.

and a mere 1.1 percent in Japan. These low inflows have been used to highlight concerns that, as a country, Japan is losing the global race to attract corporate investments that could be key to reinvigorating the economy especially in one of the most dynamic regions in the world.

With a mandate to double FDI stocks from the office of the Prime Minister in the early 2000s, Japan has certainly taken steps to increase foreign commercial presence within its borders. One indicator suggests that whereas foreigner constituted about 5 percent of investors at the Tokyo Stock Exchange in 1987 they had increased to become the largest single group at 28 percent in 2007. Another indicator concerns Japan's merger and acquisition activities, which remain small in comparative perspective – 2,775 deals in Japan in 2006 compared to 13,700 in the US and over 14,700 in Europe to the US – but which are expected to quadruple in the near future; within this surge, there is already increased foreign purchase of Japanese assets. These changes are attributed to the fundamental shift in shareholder structure and the declining role of main banks; in its place there is the rise of institutional investors as the new, dominant, and return-driven shareholders. Such changes are underpinned and reinforced by legal reforms, stretching between 1998 and 2006, which affect shareholder rights, legal recourse, and internal management control. In turn, presumably, this far more market-oriented approach in the corporate world should make Japan more receptive to inward FDI and ownership as well.

But even as Japan has made notable strides toward market-orientation, there are also some parallel legal changes that should be noted with respect to cross-border investments involving Japanese interests. First, Japanese courts stand to become significant players in instances when private interests are damaged abroad. For close to eighty years, starting with the seminal case of *Matsuyama v. Republic* of China case in 1928, Japanese courts did not for the most part sit in judgment of foreign sovereign acts; and the acts of foreign sovereigns thus remained out of reach of Japanese courts. But in July 2006, the holding of a case has had the effect of limiting the ability of foreign governments to claim immunity from the civil jurisdiction of Japanese courts when they are involved in non-sovereign commercial or business activities – much in line with the international trend. This may affect outcomes such as expropriations or contract breaches involving Japanese investments abroad. Second, the Foreign Exchange and Foreign Trade Act (FEFTA, formerly known as Foreign Exchange and Foreign Trade Control Law, (FECL) enacted in 1949), was amended in 1991 to allow the government to constrain or prohibit foreign investment in the interest of national security, public order, public safety, and economic management. All foreign investment in all industries still require notification, whether designated or not. In contrast to designated sectors that require after the-fact-notification, sectors designated sensitive require prior notification and government approval. Mirroring the US Exon-Florio Amendment, a Japanese Cabinet Ordinance in September 2007, further tightened prior notification requirements for investments in dual-use industries with weapons and defense implications.

Preliminary Summing Up

From the analysis thus far, there are several things to note: First that there are concrete corporate and governmental interests in promoting and securing investments across borders, that are not likely to go away. Second, the promotion and security of investments relies not so much on some overarching multilateral structure of governance, but rather in a patchwork of treaties and regulations ranging from the plurilateral to bilateral and increasingly national regulatory levels. Third, mirroring the US, the UK, Germany, and Japan show trends that national regulations on inward FDI are moving ever more heavily to incorporate the undefined paradigm of national security. How and whether this will affect actual investments remains to be assessed on a case-by-case notification and review basis.