INVESTMENT SCREENING TO SUPPORT BETTER MARKETS

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# Table of Content

Executive Summary ........................................................................................................... A

1. Introduction .................................................................................................................... 1

2. Quality of foreign investment in emerging market economies .............. 5
   A. CIPE’s notion of corrosive capital .............................................................................. 6
   B. OECD FDI Qualities Indicators ............................................................................... 8
   C. FDI Sustainability Characteristics ....................................................................... 11

3. Assessment of investment screening in OECD countries .................. 14
   A. Scope ......................................................................................................................... 15
   B. Size and type of investment .................................................................................... 20
   C. Decision-making and administering authority ....................................................... 23
   D. Procedure and timeline .......................................................................................... 25
   E. Possible outcomes of screening ........................................................................... 26

4. Recommendations for investment screening in emerging economies ... 31
   A. Scope ......................................................................................................................... 31
   B. Size and type of investment .................................................................................... 37
   C. Decision-making and administering authority ....................................................... 40
   D. Procedure and timeline .......................................................................................... 41
   E. Possible outcomes of screening ........................................................................... 41

5. Investment screening compliance with international law ................. 43
   A. International Investment Regime ............................................................................. 43
   B. GATS ........................................................................................................................ 46
   C. TRIMs Agreement .................................................................................................... 50
   D. The OECD Code of Liberalization of Capital Movements .................................... 51

6. Conclusion .................................................................................................................... 55
Executive Summary

Foreign investment is traditionally perceived as a positive input in a country’s economy, as it increases the amount of capital available to finance productive activities. Moreover, foreign capital often comes with technology spillovers, human capital formation, and international trade integration, increasing the productivity of industries in recipient countries. However, capital inflows into a country are not without harm or peril. In specific situations, governmental authorities have identified risks to the national security or more broadly, national interest, arising out of foreign takeovers, capital infusions, and loans, among others.

Recently, emerging market economies have faced an influx of foreign capital that “lacks transparency, accountability, and market orientation flowing from authoritarian regimes into new and transitioning democracies”.¹ This type of investment can corrode institutions and undermine the rule of law. In addition, in recent years emerging economies’ governments, international organizations, and scholars have inquired about the characteristics that foreign investment should have to contribute to the sustainable development of host states. Moreover, efforts have been made to classify the dimensions in which inward capital can aid to these goals, namely: economic, social, environmental and governance.²

On their account, advanced economies have largely relied on investment screening mechanisms to suspend, condition, or even block transactions that they deem incompatible with their national security. Countries like Australia or Canada use investment review to assess more broadly whether a transaction is consistent with the national interest or generates net benefit to their economy.

This notion could be used by emerging markets wishing to deploy investment screening mechanisms with the objective of blocking or conditioning corrosive capital, while not deterring the entry of constructive capital that would further sustainable development.

In their attempt to do so, emerging markets must bear in mind their international obligations. Concerning the international investment regime, they should endeavor to exclude pre-establishment national treatment and performance requirements commitments in their international investment agreements, or, at least, carve-out their investment screening legislation as non-conforming measures. With regard to the WTO, an investment screening mechanism should be applied with special caution concerning transactions related to the services sector, considering the specific commitments made by each country within the General Agreement on Trade in Services (GATS) and must not impose conditions deemed inconsistent with national treatment obligations specified in the Agreement on Trade-Related Measures (TRIMs Agreement), such as local content requirements for goods. Finally, if a country is considering adhering to the OECD Code of Liberalization of Capital Movements, it might try to lodge a reservation stating that it will conduct investment screening.

All in all, investment review could be a powerful policy tool by emerging economies to maximize the contribution that international investment generates in their markets.
1. Introduction

Foreign investment is traditionally perceived as a positive input in a country’s economy, as it increases the amount of capital available to finance productive activities. Moreover, foreign capital often comes with technology spillovers, human capital formation, and international trade integration, increasing the productivity of industries in recipient countries. However, capital inflows into a country are not without harm or peril. In specific situations, governmental authorities have identified risks to the national security or more broadly, national interest, arising out of foreign takeovers, capital infusions, and loans, among others.

To confront these situations, a significant number of advanced economies have deployed investment screening mechanisms, through which governments are allowed to suspend, condition, or even block transactions that they deem incompatible with a set of principles. These proceedings have been in place in developed nations over more than four decades. However, only recently they have gained prominence in the popular debate in many countries.

Likewise, during the last few years and after a period of rapid economic liberalization, emerging markets have been challenging the idea that any foreign investment is a good investment. As stated, normally foreign investment will have a positive impact in emerging economies, given that it provides the capital that is usually relatively scarce in those countries and contributes to increasing productivity through technology transfers. However, capital can also be corrosive when it lacks transparency, accountability, and market orientation and, as a consequence, undermines trust in institutions, weakens the rule of law, fosters opacity, and seeks to undermine markets. When foreign investment has these harmful outcomes, it might be sensible for

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emerging market economies to devise mechanisms allowing them to review or screen foreign capital entering into their markets.

Additionally, policy intervention is often required to ensure that foreign investment is conducive to better standards of living for a host country’s population. Not all foreign direct investment (FDI) has the same potential impact for development; for instance, FDI in extractive industries may generate very different environmental, social and political impact than FDI in high-tech manufacturing. In that sense, investment screening could be one of the pre-entry policy tools that helps maximizing the contribution of foreign investment, considering the myriad of impacts that it can have on host countries.

The objective of this report is to carry out an assessment on investment screening principles and proceedings that could be used by emerging market economies, based on the current investment screening mechanisms implemented by developed economies, in order to screen out or condition the entrance of corrosive capital and maximize the contribution of investment to sustainable development. To achieve this objective, the report has four sections:

I. Criteria to evaluate foreign investment quality in emerging market economies
II. Good practices in existing investment screening mechanisms in advanced economies
III. Recommendations on the design and structure of investment review for emerging market economies
IV. Assessment of the compliance of the proposed recommendations with international law

The second section of this report explores the different analytical frameworks that have been developed to assess whether foreign investment

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has a positive impact on the economy of recipient countries. First and foremost, it will use the notion of corrosive capital developed by the Center for the International Private Enterprise (CIPE). However, it will also take into account other proposals, such as the Organization for Economic Co-operation and Development (OECD) FDI Qualities Indicators and scholars’ work on sustainable FDI characteristics, which have a clear focus on sustainable development.

The third section assesses in depth the existing criteria, procedures and possible outcomes in investment review mechanisms currently in place in relevant advanced economies, namely, Australia, Canada, the United States (US), Japan, France, Germany, and Hungary. These countries have been chosen to canvass different models of investment screening and to have a sample of countries with different sizes and in different levels of economic development.

To analyze the selected regimes, the report takes into account the following analytical categories: (a) scope; (b) size and type of investment; (c) decision-making and administering authority; (d) procedure and timeline; and (e) possible outcomes. The objective of this section is to identify the best practices carried out by the selected jurisdictions in order to later assess whether they could be replicated in emerging market economies.

Taking into account the lessons of sections 2 and 3, the following section deploys certain recommendations concerning the design and development of investment screening mechanisms in emerging market economies. Given the needs of such countries, the focus of this policy tool would be to block or condition corrosive capital, while not deterring the entry of constructive capital that would further sustainable development.

Finally, Section 5 preemptively assesses the consistency of the recommendations with the most salient international obligations of emerging market economies. Specifically, it will consider if the proposed mechanism could entail a breach of the international investment regime—embodied in the network of international investment agreements (IIAs); the relevant World
Trade Organization (WTO) Agreements—i.e., the General Agreement on Trade in Services (GATS) and the Trade-Related Investment Measures Agreement (TRIMs Agreement); or, for specific countries, the OECD Code of Liberalization of Capital Movements. Wherever contingencies are identified, the report proposes potential adjustments and measures to be taken to minimize risk of breach of international law.
2. Quality of foreign investment in emerging market economies

Development economics give a pivotal role to foreign investment as a catalyzer of economic emergence and technological catching-up in developing countries and emerging economies. Scholars, governments, and international organizations have identified that foreign capital inflows, particularly FDI, have a positive effect on the host country’s economy. The company that receives the investment is not the only beneficiary. Those that are related to its value chain gain too by receiving positive spillovers from the influx of capital. Typically, FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, strengthen managerial and organizational skills, and helps creating a competitive business environment; generating higher economic growth as ultimate outcome.5

Given this overall positive effect of foreign investment in recipient countries, during the first years of liberalization of capital inflows in emerging market economies and developing countries, most of the concerns gravitated around the appropriateness of domestic policies and conditions to reap all the benefits of foreign capital influx. In that sense, some studies showed that in order to truly benefit from foreign investment, a country should have sound institutions and well-developed local financial markets.6 Availability of a substantial stock of human capital is also instrumental to take advantage of the increase of productivity that FDI usually generates.7

However, more recently the focus has been on the quality of the foreign investment coming into the emerging markets and developing countries. Particularly, some institutions and stakeholders have expressed concerns over the risks that certain types of capital could generate in emerging market economies and institutions. Furthermore, World Bank staff has stressed on the importance of governments deploying the “right mix” of policies to maximize FDI’s positive effects on development. The existence of different types of foreign capital—such as natural resource-seeking, market-seeking, efficiency-seeking, and strategic asset-seeking investment—\(^8\) and the fact that they have unique impacts in hosts countries’ economies warrants the existence of policies that recognize the nuances, prevent risks, and maximize FDI’s potential.\(^9\)

A. CIPE’s notion of corrosive capital

The Center for International Private Enterprise (CIPE) has coined the term corrosive capital to identify capital that “lacks transparency, accountability, and market orientation flowing from authoritarian regimes into new and transitioning democracies.”\(^10\) According to CIPE, corrosive capital—which could be private or public and take the form of any kind of financial instrument—can exploit governance gaps and, consequently, erode the rule of

\[^8\] Natural resource-seeking investment is motivated by the investor’s interest in accessing and exploiting natural resources, market-seeking investment is motivated by the investor’s interest in serving domestic or regional markets, strategic asset-seeking investment is driven by the investor’s interest in acquiring strategic assets (brands, human capital, distribution networks, etc.) that will increase its competitiveness, and efficiency-seeking investment corresponds to investment that comes into a country seeking to benefit from factors that enable it to compete in international markets. See: John H. Dunning, “Toward an Eclectic Theory of International Production: Some Empirical Tests”, *Journal of International Business Studies, Vol. 11, No. 1* (Spring - Summer, 1980): 9-31.


law in the recipient country by fostering corruption, expansion of political patronage, reduction of transparency, and greater political repression.

For instance, in Sri Lanka, the government secured loans on commercial terms from a state-owned Chinese bank for the construction of a port in Rajapaksa, sole-sourced to a state-owned firm from China, despite serious doubts about the economic feasibility of the project. When the lack of revenue became evident and the debt burden untenable, the government of Sri Lanka was forced to cede the port and 15,000 acres to China. This investment was part of China’s Belt and Road Initiative (BRI), by which the emerging power aims to strengthen infrastructure, trade, and investment links with over 71 countries, investing heavily in large infrastructure projects. BRI projects in Sri Lanka have been generally criticized due to risks of Sri Lanka falling into a ‘debt trap’, the displacement of its local workers by both legal and illegal Chinese labor, and increased security risks for Sri Lanka and the neighborhood.

Similarly, Russian companies have invested heavily in the Balkans in strategic industries, such as media and energy, without clarity of the Russian government’s involvement in those operations. Some stakeholders argue that this move is part of Moscow’s strategy to nurture economic and trade relations in strategic sectors to create greater dependencies on Russia and increase its influence in the region, due to its geopolitical significance.

In that sense, corrosive capital can undermine democratic institutions when it takes advantage of institutional weaknesses, embroiling emerging

11 Ibid., 13 - 14.
markets in unnecessary and uneconomical projects that only benefit firms from the home country of the investment.

CIPE has also expressed concerns with regard to China’s approach to development finance extended by state-affiliated banks—especially in Southeast Asia, since it is often tied to procurement conditions favoring Chinese SOEs and labor. Moreover, regulatory weaknesses in recipient countries might result in them falling into debt traps.16

In addition to this type of corrosiveness, foreign capital could also be detrimental to recipient economies whenever it does not contribute to the sustainable development goals of host countries.

B. OECD FDI Qualities Indicators

Within its work related to the Sustainable Development Goals (SDGs), the OECD has proposed a set of indicators that measure the sustainable development impact of FDI in host countries. The indicators are clustered in five relevant areas: (i) productivity and innovation; (ii) employment and job quality; (iii) skills; (iv) gender equality; and (v) carbon footprint. The following chart depicts which indicators are related to each area:

Using this framework, the OECD has measured the differences between foreign and local investment, considering cross-country variances, as to their contribution to the achievement of the SDGs. In that sense, it has found that, while FDI generates productivity and innovation gains in OECD countries, it is not evident that it has the same effect in developing countries, since in their case FDI is more prevalent in labor-intensive and less innovative manufacturing industries. In that sense, emerging economies with a pre-existing industrial base may aim to attract FDI in higher value added sectoral value chains to advance their industrialization process.

The level of development and production structure of host countries also determines FDI's contribution to employment and job quality. With regard

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18 Ibid., 17.
to job creation, investments in capital-intensive industries, such as mining or biotechnology, generate fewer jobs per dollar invested than those in labor-intensive industries, e.g., garment manufacturing or healthcare. With regard to wages, advanced economies tend to attract FDI in highly paid services—usually capital-intensive, while less advanced countries attract FDI in labor—intensive, low-skill, and low-wage industries.\(^{19}\)

In that sense, emerging markets might have to prioritize. Either they incentivize more actively FDI in labor-intensive industries, which would generate a substantial amount of jobs, but lowly remunerated; or they can aim to mainly attract foreign capital in capital-intensive industries that produce less jobs, but those that are indeed created are well remunerated. The decision would depend on the specific needs of each country.

Perhaps more importantly as to the potential risks of foreign investment, the OECD report on FDI Qualities Indicators presents evidence supporting the claim that FDI is associated with lower job security, as companies with foreign capital are characterized by higher levels of temporary jobs and lower standards of occupational safety compared to domestic firms, given the higher bargaining power of multinational enterprises.\(^{20}\)

Concerning gender equality, according to the OECD, FDI in developing countries is concentrated in sectors that are female-dominated and labor-intensive, such as garment and food industries. This is positive because it has allowed women to enter the labor force. However, it might enlarge the gender wage gap and perpetuate gender-specific labor roles, if women are only involved in this kind of low-skilled activities. To that extent, policies that support training and skills upgrading for women could be desirable.\(^{21}\)

Finally, with regards to carbon footprint, the OECD has identified that in countries that rely heavily in fossil fuel extraction, FDI is highly associated with those activities, exacerbating their dependence on extractive industries and

\(^{19}\) Ibid., 17 – 20.  
\(^{20}\) Ibid., 19.  
\(^{21}\) Ibid., 21 – 22.
increasing their carbon footprint. At the same time, between 2003 and 2017, FDI stocks in renewable energies relative to fossil fuels has increased. This shows that there is an appetite in foreign investors for greener activities. As a matter of fact, the OECD calls for policies that help transition to low-carbon energy infrastructure.

C. FDI Sustainability Characteristics

The scholars Karl P. Sauvant and Howard Mann have also worked on a framework to recognize the contribution of FDI to the achievement of SDGs. In that sense, they use the term sustainable FDI to refer to commercially viable investments that make a substantial contribution to the economic, social and environmental development of host countries, while taking place in settings of fair governance mechanisms. In their framework, FDI could have sustainability characteristics along the following four dimensions: economic, social and environmental development and governance. The contribution of their work is the identification of the common places where governments, multinational enterprises (MNEs) and other stakeholders converge as to the set of positive impacts that FDI should have, as they are reflected in treaties, standards and codes. Among others, Sauvant and Mann canvass the following instruments: international investment agreements; non-binding intergovernmental instruments, such as the OECD Guidelines for Multinational enterprises and the United Nations Conference on Trade and Development (UNCTAD) Investment Policy Framework for Sustainable Development; voluntary global business codes; and voluntary company codes.

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22 Ibid., 23.
23 Ibid., 24.
24 Karl P. Sauvant, “We need an international support programme for sustainable investment facilitation”, Columbia FDI Perspective, no. 151 (July 2015).
Table 2. FDI Sustainable Characteristics

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Economic dimension</th>
<th>Environmental dimension</th>
<th>Social dimension</th>
<th>Governance dimension</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employment</td>
<td>Resource management</td>
<td>Labour rights</td>
<td>Transparency</td>
</tr>
<tr>
<td></td>
<td>Local linkages</td>
<td>Pollution control</td>
<td>Skills enhancement</td>
<td>Local management</td>
</tr>
<tr>
<td></td>
<td>Technology transfer</td>
<td>Low carbon / greenhouse gases (GHG) footprint</td>
<td>Public health</td>
<td>Supply chain standards</td>
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<tr>
<td></td>
<td>Infrastructure</td>
<td>Waste reduction</td>
<td>Workplace safety</td>
<td>Consumer protection</td>
</tr>
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<td></td>
<td>Community development</td>
<td>Biodiversity protection</td>
<td>Non-discrimination</td>
<td>Stakeholder engagement</td>
</tr>
<tr>
<td></td>
<td>Equitable distribution of wealth</td>
<td>Climate change</td>
<td>Fair wages</td>
<td>Anti-corruption</td>
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<td></td>
<td>Tax accountability</td>
<td>Water</td>
<td>Benefits</td>
<td>Legal compliance</td>
</tr>
<tr>
<td></td>
<td>Promote research &amp; development (R&amp;D)</td>
<td>Renewable energy</td>
<td>Human rights</td>
<td>Risk management systems</td>
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<td></td>
<td></td>
<td></td>
<td>Indigenous rights</td>
<td>Environmental management systems</td>
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<td></td>
<td></td>
<td></td>
<td>Gender</td>
<td>Environmental impact assessment / social impact assessment</td>
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<td></td>
<td>Resettlement</td>
<td>Human rights due diligence</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Corporate governance</td>
</tr>
</tbody>
</table>

Source: Savant and Mann (2015).\(^{26}\)

Among the characteristics mentioned in the chart, the following are those that are more prominent along the different instruments analyzed by Sauvant and Mann:

- Low carbon footprint
- Labor rights
- Workplace safety
- Non-discrimination
- Human rights
- Resettlement

\(^{26}\) Ibid.
• Transparency
• Supply chain standards
• Stakeholder engagement
• Legal compliance

Furthermore, Sauvant and Mann submit that an international consensus is emerging about what constitutes sustainable investment with regard to the contributions to sustainable development that governments and intergovernmental agencies expect from international investors, and those that MNEs and business organizations envisage themselves making. To that extent, generating investment screening criteria inspired by these characteristics should not raise significant objections from the business community.

27 Ibid., 20 – 21.
3. Assessment of investment screening in OECD countries

Investment screening or review has been understood traditionally as a regulatory tool to control inward investment that may pose a risk for national security or other public concerns. Recently, its use has evolved considerably, as transactions dealing with domestic strategic industries and critical infrastructure have been subject to these mechanisms.28

Based on a survey of the current rules and practices from representative developed countries with regard to investment review mechanisms, this report draws some conclusions in order to make recommendations for emerging market economies to set up investment screening mechanisms that would allow them to neutralize corrosive capital and enhance the contribution of foreign investment to their sustainable development goals. The subsequent analysis is based on a comparative analysis of the existing systems in Australia, Canada, the United States, Japan and some of member States of the European Union (EU) such as Germany, France, and Hungary.

The assessment is based on analytical categories that help to find out the best practices adopted by the surveyed countries as guidance for drafting recommendations on how to establish a similar system in emerging market economies, being cognizant of the priorities and technical capacities of such countries. Specifically, the categories that this report takes into account are: (a) scope; (b) size and type of investment; (c) decision-making and administering authority; (d) procedure and timeline; and (e) possible outcomes.

A. Scope

Most countries with investment screening mechanisms use them to protect their essential national security interests. Originally, the national security notion was used to screen individual foreign investments in the military sector. However, the role of this tool has extended dramatically over the past few years.

Since the turn of the millennium, acquisitions in high-tech industries by Chinese state-owned enterprises (SOEs), in particular, have attracted public attention in many countries. Advocates of tighter investment screening warn that foreign investment in defense companies or in areas of critical infrastructure severely threatens national security. In addition, they argue that foreign acquisitions of key technologies endanger the competitiveness of the investment recipient countries. Furthermore, some proponents believe that tighter controls could be used to incentivize market access abroad (“reciprocity”).

As a result, screening has extended to foreign investment in domestic strategic industries and critical infrastructure, such as energy production and supply, water supply, transport, telecommunication, mineral resources or media. Also, nowadays, investment screening increasingly covers the acquisition by foreigners of domestic technology and knowhow, such as artificial intelligence, robotics, semiconductors, cloud computing, 5G, quantum technology, computing hardware, nanotechnologies, biotechnologies or satellites and aerospace. Security-related screening procedures have also been applied or are under consideration to control the access of foreign investors to sensitive data of domestic citizens. The public health crisis triggered by the global outbreak of Covid-19 in 2020 has led to an inclusion of

30 Ibid.
31 Ibid.
healthcare-related industries within the notion of national security in Europe, however, in other jurisdictions, like the United States, this happened several years ago.

The EU generally adopts the national security-based model. The European authorities recently created a regional framework for investment screening, laying down the foundations for a systematic exchange of information between Member States and the European Commission (EC). Despite the novelty of the regulation—it was enacted in 2017—the main criteria to be considered by national authorities are security and public order. While Member States keep the last word on whether to allow a specific investment in their territory, the regulation introduces a new EC competence to screen foreign investments and issue non-binding opinions. The EC competence is activated if (i) a transaction in a Member State may affect security or public order of projects or programs of EU interest in the areas of research, space, transport, energy, and telecommunications; or (ii) a transaction in a Member State may affect the security or public order of other Member States.

For instance, in Germany, the Federal Ministry for Economic Affairs and Energy must be notified of any planned non-EU investment in critical infrastructure and any non-German investment in security-related technologies whereby the investor directly or indirectly acquires 10 per cent or more of the company’s voting rights. It is noteworthy that, in 2018, Germany broadened the definition of critical infrastructure in its screening process to include news and media companies critical for the formation of public opinion.

The case of the United States is similar, as the Committee on Foreign Investment in the United States (CFIUS) is an interagency body that assists

the President in reviewing the national security aspects of foreign direct investment in the US economy.\textsuperscript{35} Section 721 of the Defense Production Act of 1950, as amended, establishes that the President may suspend or block a transaction if no other laws apply and if there is “credible evidence” that the transaction threatens to impair the national security.\textsuperscript{36}

Yet, there are systems that go beyond national security and public order when reviewing investment, such as those deployed in Australia, Canada and Japan.

The Foreign Acquisitions and Takeovers Act of 1975 (“FATA”) of Australia allows its government to block, or condition investment proposals, if the transaction could be contrary to Australian “national interest”. The FATA illustrates factors to be taken into consideration to determine whether a proposed investment is consistent with national interest:\textsuperscript{37}

- National security: Ability to protect its strategic and security interests.
- Competition: Promote healthy competition and avoid excessive concentration.
- Taxation: Impact of foreign investment on tax revenues.
- Environment: Environmental impact of the investment.
- Impact on the economy and the community: eventual plans to restructure Australian enterprises and fair return to Australians.
- Character of the investor: Extent to which the investor operates on a transparent and commercial basis. Also, if it is subject to adequate and transparent regulation and supervision.
- With regards to residential land, the Australian government favors investments that increase the housing stock.

\textsuperscript{35} James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)”\textit{ Congressional Research Service} (February 2020).
\textsuperscript{36} Ibid.
\textsuperscript{37} Treasurer of Australia. Australia’s Foreign Investment Policy. 2019. p. 9-12.
Concerning of agricultural sector, the Australian government assesses the impact of the proposed transaction on quality and availability of agricultural resources, land access and use, agricultural production and productivity, food security, biodiversity, employment and prosperity in local and regional communities.

The inclusion of the impact on competition as a relevant factor deserves further elaboration. Typically, the impact of a transaction proposal that raises competition concerns is analyzed through the merger control framework in place in most advanced and emerging economies, which are handled by competition authorities. This is also the case of Australia, where the Competition and Consumer Commission is in charge of merger clearances in accordance with Australia’s competition policy regime, and such examination is independent of the investment screening framework.38 The distinctive element of the competition analysis conducted through the investment screening framework is that the government also considers the impact that a proposed investment would have on the make-up of the relevant global industry, particularly if an investment may allow an investor to control the global supply of a product or service. These considerations about the global markets would not typically be included in traditional merger control, as authorities here tend to focus on the effects of the transaction on domestic markets.39

An example can be illustrative in this point. Australian authorities blocked the acquisition of a rare earths miner by an acquirer from China, given that Chinese companies already control a significant portion of the world’s supply of rare earths.40

In Canada, in addition to national security, according to the Investment Canada Act, reviewable investments are screened to determine if they are of

38 Ibid., 10.
39 Ibid.
“net benefit” to Canada. Such a determination is made considering the following factors:\[41\]

- The effect on the level and nature of economic activity in Canada, including employment, resource processing, the utilization of parts and services produced in Canada, and exports from Canada.
- The degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada.
- The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada.
- The effect of the investment on competition within any industry in Canada.
- The compatibility of the investment with national industrial, economic and cultural policies.
- The contribution of the investment to Canada's ability to compete in world markets.

As in Australia, Canada has a specialized competition authority, the Competition Bureau, that normally assesses the impact of a proposed merger on competition. However, unlike Australia, Canadian authorities in charge of investment review tend to defer to the Competition Bureau's judgement as to the competitive effects of an investment and encourage foreign investors to discuss them with the competition authorities, before finalizing their review.\[42\]

Canada also maintains cultural sector investment review, under which proposed new investments that could result in ownership and control of

\[42\] Getting The Deal Through, "Foreign Investment Review – Canada", https://gettingthedelealthrough.com/area/48/jurisdiction/7/foreign-investment-review-2020-canada/
Canadian cultural businesses by foreign investors are governed by Ministry of Canadian Heritage. Such businesses include those involved in the publication, distribution or sale of books, magazines, periodicals, newspapers or music in print or machine readable form.\(^{43}\)

B. Size and type of investment

The threshold that triggers an investment review varies depending on the kind of investor (if it is of governmental nature or not) and on the size, type, or sector of investment to be made.

Countries generally exercise a tighter scrutiny when the investor is a foreign government or a foreign SOE—due to concerns generated by states’ interventions in private ownership—and apply more ample screening thresholds for investors that are nationals from or incorporated in trade partner countries. For example, a proposal to acquire a substantial interest in an Australian entity that is valued above AUD 266 million (approximately USD 153 million) requires approval from the Treasurer. However, all proposals by foreign governments and SOEs to acquire direct interest in a business in Australia (generally at least 10 per cent) or acquire an interest in Australian land regardless of the value of the investment require prior approval by the Australian government.\(^{44}\)

In Canada, private sector investors face a review threshold of CAD 1,075 million (approximately USD 741 million) in enterprise value for investments to directly acquire control of a Canadian business, meanwhile the value for investments made by SOEs is CAD 428 million (approximately USD 295 million).\(^{45}\)


In France, the Decree No. 2019-1590 modifies the threshold in order for an investment to be subject to prior authorization. From April 2020, shares exceeding 25% of voting rights in an entity governed by French law will trigger control of investments for non-EU investors. This threshold previously was 33.33%.46

The German government tightened investment screening in 2017 and 2018. The threshold above which investments from third countries can be prohibited has been lowered from 25 percent to 10 percent for critical infrastructures.47

In Hungary, prior ministerial approval is required, when: 1) 25% of the shares (10% in publicly traded companies) are acquired in companies important to the national security; 2) decisive influence over such companies is acquired; 3) a branch office is established in Hungary, or 4) a right to use/operate a sensitive infrastructure or asset is acquired.48

It is worth noting how in countries where the criterion to review foreign investment proposals is national security, like all the European countries surveyed, there is no monetary threshold that must be exceeded for a transaction to be screened. Taking this into account, the rules established in Australia and Canada are more relevant for this study, given that their thresholds are useful to limit and rationalize the amount of transactions that have to go through screening in systems that go beyond national security. In general terms, these countries do not screen investment proposals for businesses valued at less than USD 150 million.

Concerning the type of financial instrument (FDI, portfolio investment and loans), in general, investment review mechanisms are applicable to the investments that convey a right to the profits or the control of target companies. Portfolio investments or loans are not ordinarily subject to investment screening.

For example, in the United States, CFIUS jurisdiction extends over “covered transactions”, which are defined as any merger, acquisition, or takeover that could result in foreign control of any United States business.\(^\text{49}\) In that sense, investment transactions that are undertaken “solely for the purpose of passive investment” or an investment in which the foreign investor has “no intention of determining or directing the basic business decisions of the issuer” are not subject to CFIUS review.\(^\text{50}\) Following the 2020 Treasury Department Regulations, passive investments are defined as those in which the investor does not plan or intend to exercise control.\(^\text{51}\) This would preclude CFIUS review over portfolio investments. Concerning debt instruments, the new regulations stipulate that the extension of loans by a foreign person to a US business will not be considered a covered transaction, unless the loan conveys a right to the profits of the business or involves a transfer of management decisions.\(^\text{52}\)

On its account, the new regulation of the EU targets FDI in particular, (it does not apply to portfolio investments), capturing any type of investment by a foreign investor which aims to establish or maintain “lasting and direct links” between the investor and the other party receiving the funds.\(^\text{53}\)

\(^{49}\) James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)” *Congressional Research Service* (February 2020).

\(^{50}\) 31 C.F.R. § 800.302.

\(^{51}\) 31 C.F.R. § 800.243.

\(^{52}\) James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)” *Congressional Research Service* (February 2020).

Therefore, although there are no clear determinations on this topic, investment in securities and loans are not usually under the purview of investment screening authorities.

C. Decision-making and administering authority

Most of the countries surveyed confer the authority of conducting investment screening to the minister responsible in the areas of Treasury, Economy or Industry. In certain countries, such as the US and Australia, the responsible minister is advised by a collegiate committee or board.

In the US, CFIUS is an interagency committee which reviews the transactions that go through screening. The Secretary of the Treasury is the chairperson of CFIUS, and the members of the committee include the heads of the various departments and offices related to national security, such as the Department of Homeland Security, the Department of Commerce, the Department of Defense, the Department of State and the Department of Energy. It is noteworthy that in the US, the President is the only officer with the authority to suspend or prohibit mergers, acquisitions, and takeovers.

In Australia, the Treasurer has the power to decide in each case whether a particular proposal would be contrary to the national interest. The Treasurer is advised by the Foreign Investment Review Board (FIRB), which examines foreign investment proposals and advises on the national interest implications. Responsibility for making decisions rests with the Treasurer. In practice, most of the caseload is carried by the FIRB. Only concerning cases politically salient, the FIRB makes a recommendation and the Treasurer may agree or disagree with said recommendation. The board is composed of 6 part-time

54 James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)” Congressional Research Service (February 2020).
55 Ibid.
members appointed by the Treasurer, as well as the Division Head of the Foreign Investment Division of the Department of the Treasury. Notably, the members of the FIRB have a wide array of experience in related matters and they hold other positions both at the private and the public sector.58

In Canada, with respect to all investments, except those related to cultural activities, the Department responsible of investment review is Innovation, Science and Economic Development Canada. With respect to cultural investments, the entity in charge is the Department of Canadian Heritage.59

Even if certain countries where investment review is conducted by a single entity, the office in charge ordinarily consults with other relevant entities, when it deems necessary, because the scope of national security is evolving and expanding and, thus, no single entity alone can handle the review properly and in a timely manner.

Finally, it is also relevant to mention that in the US, the Legislative branch plays a role in the investment screening process. In this country, the Congress has the right to be informed periodically about CFIUS activities and, if necessary, has the authority to request further detailed information. Congressional oversight was enhanced both by the Foreign Investment and National Security Act (FINSA) and the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), increasing the types and number of reports that CFIUS is required to send to certain specified Members of Congress. In particular, CFIUS is required to brief certain congressional leaders if they request such a briefing and to report annually to Congress on any reviews or investigations it has conducted during the prior year. Notably, in cases where the Committee recommends that the President suspend or prohibit a transaction because it threatens to impair the national security,

CFIUS is required to notify Congress of the recommendation and, upon request, provide a classified briefing.\footnote{James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)” \textit{Congressional Research Service} (February 2020).}

D. Procedure and timeline

Most countries allow some degree of flexibility on the timeframe within which an investment review should be completed, because each investment is under different circumstances and thus it needs to be reviewed on a case-by-case base.

In Australia, the Treasurer also has 30 days to consider an application and make a decision. However, it can extend the period up to an additional 90 days.\footnote{Treasurer of Australia. Australia’s Foreign Investment Policy. 2019.} In Canada, the Minister has 45 days to determine whether or not to allow the investment. The Minister can unilaterally extend this period by an additional 30 days. Further extensions are permitted if both the investor and the Minister agree to the extension. It is not unusual for the Minister to extend the initial 45 day review period to permit full consideration of the investment.\footnote{Government of Canada, An Overview of the Investment Canada Act (FAQs), \url{https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00007.html#q8}} In the case of investments in cultural businesses, the review will usually require at least 75 days to complete.\footnote{Sections 21-23 of Investment Canada Act} In the US, CFIUS has 45 days to conduct a review to determine if an investigation is warranted, 45 days to conduct an investigation, and then the President has 15 days to make his determination.\footnote{James K. Jackson, “The Committee on Foreign Investment in the United States (CFIUS)” \textit{Congressional Research Service} (February 2020).}

As for European countries, in France, the Minister of the Economy has 30 business days from the date of receipt of the application to notify the investor that the investment (i) is not subject to the prior authorization requirement, (ii) is subject to it and is authorized without conditions, or (iii) requires further
examination. In the latter case, the Minister has an additional 45 business days to conduct the examination. In the absence of a response from the Minister within the stated time limit, the application is deemed to be rejected. In Hungary, the Minister will decide within 60 days after the submission of the required documents and information whether the investment would harm Hungary’s security interests—in exceptional cases this deadline may be prolonged by an additional 60 days.

In general, it seems that investment reviews in advanced economies tend to last between 30 and 120 days. It is likely that longer waiting periods, in which the transaction has to standstill could deter businesses that would have a positive impact in the recipient country.

E. Possible outcomes of screening

Broadly, investment screening may prohibit a proposal that would be contrary to the principles and values protected or impose conditions, on which fulfillment is deemed necessary to remove concerns. In most cases, it also allows to make orders to foreign persons to divest shares, assets or interests.

In the Australian case, the FATA empowers the Treasurer to prohibit a proposal that would be contrary to the national interest (sections 18, 19, 20, 21 and 21A), or to raise no objections subject to conditions considered necessary to remove national interest concerns (section 25). It also permits the Treasurer to make orders for foreign persons to divest shares, assets or interests in urban land where the acquisition is decided to be contrary to the national interest. Rejection of transactions is infrequent. In 2012, only 13

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proposals were ruled out of 11,420 applications. All of the rejected proposals were related to real estate acquisitions. It is also important to note the elevated number of transactions approved subject to conditions. In 2012, they ascended to 5,803.68

As mentioned before, in the US the President is the only officer with the authority to suspend or prohibit mergers, acquisitions, and takeovers. To date, six investments have been blocked, although proposed transactions may have been withdrawn by the firms involved in lieu of having a transaction blocked. President Obama, in 2012, blocked an American firm, Ralls Corporation, owned by Chinese nationals, from acquiring a U.S. wind farm energy firm located near a Department of Defense (DOD) facility and blocked a Chinese investment firm in 2016 from acquiring Aixtron, a Germany-based firm with assets in the United States. In 2017, President Trump blocked the acquisition of Lattice Semiconductor Corp. by the Chinese investment firm Canyon Bridge Capital Partners; in 2018, he blocked the acquisition of Qualcomm by Broadcom; and in 2019, the Committee raised concerns over Beijing Kunlun Company’s investment in Grindr LLC, an online dating site, over concerns of foreign access to personally identifiable information of U.S. citizens. Subsequently, the Chinese firm divested itself of Grindr.69 Finally, in 2020, the President ordered the Chinese firm Beijing Shiji Information Technology Co., Ltd. to divest all interest in StayNTouch, Inc.70

In the US, mitigation instruments are used as an alternative to blocking the transaction. They can range from assurance letters between CFIUS and the applicants for the CFIUS review (whereby the applicants undertake corporate governance steps to address security concerns) to complex agreements that can impose burdensome operational restrictions or even require restructuring

aspects of the transaction itself. In all events, the purpose of the underlying conditions is to constrain foreign control that otherwise would result from the transaction.\textsuperscript{71}

In Canada, if the Minister decides that the investment does not represent a "net benefit" to Canada, the Act provides an opportunity for the investor to make additional representations and undertakings which would demonstrate the "net benefit" of the investment. Ultimately, if the Minister remains unsatisfied with the additional representations by the investor, he will be prohibited from implementing the investment or if the investment has already been implemented the investor will be required to divest itself of the investment.\textsuperscript{72}

In France, if the protection of public order, public security or national defense is compromised or likely to be compromised, besides blocking the transaction, the Ministry of Economy has the power to pronounce the following interim measures to resolve the situation:\textsuperscript{73}

- suspend the investor’s voting rights in the target company;
- prohibit or limit the distribution of dividends to the foreign investor;
- temporarily suspend, restrict or prohibit the free disposal of all or part of the assets related to the sensitive activities carried out by the target; and
- appoint a temporary representative within the company to ensure the preservation of national interests.

In Germany, the Federal Ministry for Economic Affairs and Energy may only prohibit an acquisition with the approval of the German federal government. Likewise, the German federal government is not entitled to

\begin{flushleft}
\textsuperscript{72} Sections 23, 24 of Investment Canada Act.
\textsuperscript{73} White & Case, “Foreign Investments in France: new legislation expands and strengthens the national security review mechanism”, https://www.whitecase.com/publications/alert/foreign-investments-france-new-legislation-expands-strengthens-national
\end{flushleft}
prohibit an acquisition if the Federal Ministry for Economic Affairs and Energy has not issued a negative assessment. When the Ministry concludes that the investment might affect the public order or security or essential security interests, investors may negotiate approval conditions or an agreement with the Ministry and the Ministry is authorized to either prohibit a transaction or attach its approval to certain conditions such as exclusion of a critical component of the transaction.\textsuperscript{74}

In Hungary, the Minister may prohibit the investment, if he seems that the investment would be contrary to Hungary’s security interests. The prohibition may not be appealed and may only be challenged in an administrative procedure.\textsuperscript{75}

All in all, most countries, in addition to block investments, include the possibility to condition the transaction to the fulfilment of a set of requirements. This practice could be relevant for emerging market economies that might have concerns beyond national security issues, and might want to remove certain corrosive conditions of a specific deal or desire to increase the developmental contribution of a project, without blocking the transaction. The next phase explores how this characteristic, and others, might be implemented in an investment screening mechanism devised for this kind of countries.

The following chart summarizes some of the most relevant information of selected jurisdictions:

\textsuperscript{74} Getting The Deal Through, “Foreign Investment Review - Germany”, \url{https://gettingthedealthrough.com/area/48/jurisdiction/11/foreign-investment-review-germany}

\textsuperscript{75} Lexology, “New Hungarian legislation on national security screening of foreign investment to apply from 1 January 2019”, \url{https://www.lexology.com/library/detail.aspx?g=0d91687c-0809-46c0-86c2-1142e878e84a}
### Table 3. Criteria for investment screening in emerging economies

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Australia</th>
<th>Canada</th>
<th>Germany</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Criteria</td>
<td>National interest:</td>
<td>National security, net benefit and Canadian heritage.</td>
<td>• National security</td>
<td>• National security</td>
</tr>
<tr>
<td></td>
<td>• National security</td>
<td>Net benefit factors:</td>
<td>• Critical infrastructure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Competition</td>
<td>• Level and nature of the economy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Taxation</td>
<td>• Degree and significance of participation by Canadians</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Environment</td>
<td>• Productivity, efficiency, technological development and variety.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Impact on the economy and the community</td>
<td>• Competitiveness</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Character of the investor</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>USD 153 million</td>
<td>USD 741 million</td>
<td>10 per cent of the equity interests</td>
<td>N/A</td>
</tr>
<tr>
<td>threshold</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decision-</td>
<td>• The Treasury with the advice of the Foreign Investment Review Board</td>
<td>• Department of Innovation, Science and Economic Development</td>
<td>• Federal Ministry for Economic Affairs and Energy</td>
<td>• The President with the advice of CFIUS</td>
</tr>
<tr>
<td>making authority</td>
<td></td>
<td>• Department of Canadian Heritage</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timeline</td>
<td>• 30 days, plus</td>
<td>• 45 days, plus</td>
<td>• 120 days</td>
<td>• 105 days</td>
</tr>
<tr>
<td></td>
<td>• If necessary, additional 90 days</td>
<td>• If necessary, additional 30 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Possible</td>
<td>• Approval, Conditional Approval, Non-approval (divesture)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>outcomes</td>
<td></td>
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</tr>
</tbody>
</table>
4. Recommendations for investment screening in emerging economies

Based on best practices in the selected investment review mechanisms in the developed world, it is possible to sketch out an investment screening system for emerging economies that wish to deter the entry of corrosive capital into their markets, while enhancing the contribution of foreign investment to their sustainable development. This section of the report lays the foundation for such a system using the same categories included in the previous section.

A. Scope

An investment review mechanism in an emerging market economy probably would not gravitate around national security concerns. Undeniably, there are legitimate national security reasons to screen investments in emerging markets. An example would be the transactions by which Russian government-backed companies invested heavily in the energy industry in the Balkans.76

However, investment review in emerging markets could have a broader scope. In addition to screening out capital that can undermine institutions and erode the rule of law, it could enhance or maximize the contribution that foreign investment makes towards its sustainable development. In that sense, notions like “national interest” or “net benefit”, used in Australia and Canada, respectively, could be useful to conceptualize the main goal of such an institution.

Furthermore, many criteria considered by Australian and Canadian authorities resonate with the sustainable development indicators of quality mentioned in Section 2 of this report. For instance, most of the factors that

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Canadian authorities take into account—such as, employment, utilization of parts and services produced locally, investment in productivity and product innovation—are also considered by the OECD as FDI quality indicators or as FDI sustainable development characteristics in the framework proposed by Sauvant and Mann. Likewise, one of the factors considered by the Australian Treasurer is the character of the investor, which is associated with the extent to which the investor operates on a transparent and commercial basis. This factor is related both to the governance dimension in the FDI sustainable development characteristics and with CIPE’s definition of corrosive capital.

In that sense, Australian and Canadian criteria can be taken as a departure point for the development of the factors that an emerging economy wishing to deploy an investment screening mechanism could consider. Moreover, the fact that these elements are already incorporated in existing systems would ease the adoption of them by emerging markets.

Taking all this into account, this report now presents an illustrative list of criteria that could be relevant for an emerging market economy aiming to attract sustainable investment. The dimensions of the FDI sustainable characteristics framework are used as structure, and then, some specific indicators—appropriated from the OECD’s work—are put forward as guidance for emerging economies’ authorities and MNEs.
Table 5. Criteria for investment screening in emerging economies

<table>
<thead>
<tr>
<th>DIMENSION</th>
<th>SPECIFIC INDICATORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>GOVERNANCE</td>
<td>Transparency</td>
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<tr>
<td></td>
<td>Supply chain standards</td>
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<td></td>
<td>Legal compliance</td>
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<td></td>
<td>Human rights due diligence</td>
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<td></td>
<td>Corporate governance</td>
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<tr>
<td>ECONOMIC</td>
<td>Labor productivity</td>
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<td></td>
<td>Labor productivity growth</td>
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<td></td>
<td>Product and process innovation</td>
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<tr>
<td></td>
<td>R&amp;D expenditures</td>
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<tr>
<td></td>
<td>Job creation</td>
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<tr>
<td></td>
<td>Wages</td>
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<tr>
<td></td>
<td>Local linkages</td>
</tr>
<tr>
<td></td>
<td>Technology transfer</td>
</tr>
<tr>
<td>SOCIAL</td>
<td>Job security</td>
</tr>
<tr>
<td></td>
<td>Worker safety</td>
</tr>
<tr>
<td></td>
<td>Skills enhancement</td>
</tr>
<tr>
<td></td>
<td>Gender employment equality</td>
</tr>
<tr>
<td></td>
<td>Gender wage equality</td>
</tr>
<tr>
<td>ENVIROMENTAL</td>
<td>CO2 emissions</td>
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<tr>
<td></td>
<td>Energy efficiency</td>
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<tr>
<td></td>
<td>Renewable energy use</td>
</tr>
</tbody>
</table>
The indicators mentioned could be assessed in innumerable ways, however, this report provides some suggestions about the kind of parameters that could be put in place by emerging economies.\textsuperscript{77}

**Governance dimension:**

- **Transparency** is related to disclosure of information relating to tax payments, supply chain due diligence, contracts, corporate governance practices, human rights, etc.
- **Supply chain standards** refers to sustainable and responsible business practices related ethics, labor, health, and safety, diversity, and the environment for supply chains of MNEs.
- **Legal compliance** refers to compliance with the laws and standards promulgated by host countries, including compliance with corruption related laws, provisions against bribery of public officials etc. Here the legal regimes to which the foreign investor is subject in its home country might also be relevant.
- **Human rights due diligence** is related to investors’ processes to identify, prevent and address impacts on human rights.
- **Corporate governance** includes aspects such as accounting practices and corporate accountability. Here countries could inquire about the involvement of the government in the decision-making process in the case of SOEs.

In this dimension, emerging market economies could identify the corrosiveness of investment proposals (including loans) that could come from obscure sources or from investors that do not comply with accepted international standards on anti-corruption, human rights, and corporate governance, among others.

\textsuperscript{77} Most of these recommendations are based on the details provided by Mann and Sauvant (2019) concerning the FDI sustainability characteristics and in the OECD report of FDI Qualities.
Economic dimension:

- **Labor productivity** is usually measured as value added by employee and **labor productivity growth** would be the increase of this unit arising from the foreign investment. The latter indicator would be especially relevant for brownfield investment.
- **Product innovation** refers to the foreign investor’s plans to enhance the product, while **process innovation** refers to the new techniques and technologies that the investor would bring to the host country.
- **R&D expenditures** refers to the commitments by investors to undertake research and development activities in the host country.
- **Job creation** could be measured as number of new jobs per unit of FDI.
- **Wages** refers to the salaries that the foreign investor plans to provide to its employees.
- **Local linkages** entails linkages with the local economy, such as procurement from local suppliers.
- **Technology transfer** relates to foreign investors’ plans to transfer technology to domestic partners.

In the economic dimension, governments can assess the degree to which foreign investment contributes to their specific economic development goals. Depending on the needs of each country, they could put more weight on productivity and innovation—for countries with a reasonably developed industrial base—or in job creation for countries that have large sectors of their population outside of the formal economy.

Social dimension:

- **Job security** can be measured as the proportion of contracts that are longer than 12 months.
- **Worker safety** could be assessed by the workers’ injuries track of the investor in other countries.
• **Skills enhancement** includes, among others, skills development of workers so as to allow them to access better work opportunities.

• **Gender employment equality** is usually measured as the relative share of female workers, while **gender wage equality** refers to women’s wage relative to men’s wage.

Assessing the social dimension of transactions would allow countries to enhance the contribution of foreign investment to the betterment of the social fabric and prevent issues, such as the connection of foreign investment with low levels of job security.

**Environmental dimension:**

• **CO₂ emissions** targets reducing emission of greenhouse gases and is measured as emissions per unit of output.

• **Energy efficiency** is usually measured in terms of output produced for a given level of electricity and heat consumption.

• **Renewable energy use** refers to the amount of energy needs that the investor plans to meet from sources that are naturally replenishing. It generally is considered to include six renewable-power generation sectors: geothermal, marine/tidal, small hydroelectric, solar, wind, and the combined sector biomass and waste.

Finally, the environmental dimension allows countries to assess the negative externalities on the environment of, specially, large investment projects, looking to minimize them.

Evidently, not every criterion is going to have the same weight for each country and some states might decide to include other factors. Furthermore, as mentioned by the World Bank staff, different types of investment can generate different economic, social, environmental and governance impacts.\(^78\)

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To that extent, governments would have to calibrate the application of the screening dimension and indicators depending on the kind of transaction under scrutiny. Whereas natural resource-seeking investment clearly will have substantial environmental impacts and authorities might want to establish a high bar on the environmental indicators for transactions of this kind; efficiency-seeking investment, which is likely to rely heavily on the relatively cheap labor force of emerging markets, should be especially analyzed through the economic and social lenses. Market-seeking and strategic-asset seeking investment should be particularly scrutinized under the economic dimension angle to assure that these transactions will effectively increase, inter alia, domestic productivity, R&D investment, employment, wages and/or technology transfer.

In any case, this indicative list could be a first step for the government of an emerging market to devise an investment screening mechanism that aims to further the “national interest” or to promote investments with “net benefit”, having sustainable development at the core.

**B. Size and type of investment**

As mentioned before, in developed countries the threshold that triggers an investment review to determine whether an investment proposal requires approval varies depending on the nature of the investor (if it is of governmental nature or not) and on the size, type or sector of investment to be made.

As for the nature of the investment and in order to counter concerns about lack of transparency and market orientation of capital inflows, it would be sensible to require that any investment made by a foreign government or a SOE should go through the review mechanism. In order to rationalize the burden on the administering authorities a threshold like the one adopted in Australia could be implemented. In this country, acquisition of more than 10 percent of an Australian business by a foreign government or a SOE is
subject to automatic review. Emerging markets could adopt higher threshold if they deem that the 10 percent level would generate excessive workload, considering their capacity constraints.

With regard to the type of financial instrument, most investment screening mechanisms do not formally differentiate among them, but in practice focus their efforts on FDI. Nonetheless, important jurisdictions, like the US, allow for the possibility of screening loans when the transaction implies a right to profits or involves a transfer of management decisions. In that sense, emerging markets could keep a broad definition of investment and not decline a priori their right to screen portfolio investments and foreign loans.

Additionally, CIPE warns that corrosive capital could come in the form of less permanent kinds of investment, such as loans. This is another argument to keep a broad definition of investment, that includes FDI, loans and even portfolio capital. Such a determination might be burdensome, as it adds additional workload to the investment review process. However, the strict scrutiny may be necessary to prevent lending arrangements having corrosive conditions, like the ones mentioned when discussing Sri Lanka’s port project. It is worth noting that corrosiveness in lending instruments has been identified especially in contracts where the borrower is a public institution. In that sense, emerging markets could limit review over loans for those that involve public lending. And with regard to transactions where the borrower is a private actor, only screen when the foreign person acquires financial or governance rights characteristic of an equity investment, or when an imminent default could give a foreign person actual control of collateral.

In any event, most of the activity that national authorities would have to face is related to FDI. More than half of the total private capital flows into a selected group of emerging markets between 1998 and 2014 corresponded to FDI flows. The disaggregated data can be seen in the following table:
Table 6. Private Capital Inflows to Selected Emerging Economies\textsuperscript{79}

\begin{center}
(billion dollars)
\end{center}

\begin{center}
\begin{tabular}{|l|c|c|c|c|c|}
\hline
\hline
Total capital inflows & 153,953 & 1,261,256 & 682,401 & 1,213,139 & 1,048,077 \\
\hline
FDI & 141,115 & 490,750 & 535,367 & 521,227 & 585,971 \\
\hline
Portfolio investments & 15,553 & 83,563 & -82,573 & 147,035 & 101,216 \\
\hline
Total debt inflows & -2,694 & 686,943 & 229,607 & 544,877 & 360,891 \\
\hline
\end{tabular}
\end{center}

Source: Institute of International Finance\textsuperscript{80}

Finally, emerging economies might want to include a monetary threshold above which investment proposals have to be notified and reviewed. Otherwise, they might end up imposing cumbersome burdens to small investors, which could turn to different countries without the same kind of regulation. As mentioned before, developed countries that review investment with criteria that go beyond national security—like Australia and Canada, do not screen proposals for businesses valued by less of USD 150 million. In emerging market economies an average FDI deal has a value around USD 100 million.\textsuperscript{81} To that extent, the USD 150 million threshold could be taken into consideration, since most transactions could be materialized without going through review. Evidently, each country would have to establish its own threshold having due regard to the size of its economy and the average size of cross-border inward transactions.

\textsuperscript{79} The selected countries are Argentina, Brazil, Bulgaria, Chile, Colombia, Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, Malaysia, Mexico, Morocco, Peru, Poland, Romania, South Africa, Turkey.


C. Decision-making and administering authority

The minister in charge of economic affairs tends to be the entity in charge of investment screening mechanisms in advanced economies. There is no reason why this should be different in emerging economies.

A trickier question is whether to put in place an advisory committee that would assist the entity in charge to assess the investment proposals and their contribution to the national interest (to use Australia’s notion). Having a committee where the relevant entities of the government have a seat brings relevant expertise to the table. Additionally, it might help to avoid agency capture. Especially in cases where the transaction that involves corrosive capital are loans conferred to governmental agencies, such as the undisclosed loans provided by Chinese state-owned banks to Argentinean government ministries. With an advisory committee it would be harder for a foreign interest to capture governmental bodies, since it would have to engage with more than one entity. However, this institutional arrangement by no means should be seen as an absolute guarantee against government capture and additional safeguards might be necessary.

Moreover, the Australian system, where the board includes members that have roles in the private sector, might help to generate accountability from the business community. Now, involving the private sector could also lead to conflict of interest, which would need to be clearly disclosed and dealt with.

In any event, it seems that the best alternative for emerging economies would be to put in place a body of this nature that could advise the economic entity that conducts the process.

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D. Procedure and timeline

As mentioned, most countries allow some degree of flexibility on the timeframe within which an investment review should be completed, because each investment is under different circumstances and thus needs to be reviewed on a case-by-case basis. However, broadly speaking, investment reviews in advanced economies tend to last between 30 and 120 days. It is likely that longer waiting periods, in which the transaction has to standstill could deter businesses that would have a positive impact in the host country. Emerging markets putting in place an investment review institution should aim to remain within this range to avoid unnecessarily hampering foreign investment.

E. Possible outcomes of screening

Finally, investment screening does not only end up with blocking transactions. All the analyzed jurisdictions allow the administering authorities to impose conditions on investors to execute the operation. Some countries use extensively this prerogative, such as Australia, where the Treasurer conditioned 5,803 proposals in 2012.\(^\text{83}\)

This practice could be especially relevant for emerging economies that are not only concerned with national security issues, but that might want to remove certain corrosive conditions of a specific deal or desire to increase the contribution of a project to the achievement of their development goals. It is unlikely that the authorities of an emerging economy would block an investment because it does not contribute enough to its economic, social or environmental development. However, the government might be interested in imposing certain requirements on the investors to mitigate the risks that the transaction might have on those dimensions or to enhance the contribution of

the proposal to its sustainable development. In that sense, an investment screening mechanism could develop into a pivotal policy tool to generate synergies between private and public sector to enhance the contribution of foreign investment to fulfil policy goals.
5. Investment screening compliance with international law

Lastly, this report confronts the investment screening mechanism sketched in the previous section with the most salient international obligations of emerging markets in the field of foreign investment. Specifically, it assesses whether putting in place an institution of such nature and with the characteristics spelled out in the previous section would carry risks of breaches of international investment agreements, the relevant WTO Agreements—i.e., the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Investment Measures (TRIMS), and the OECD Code of Liberalization of Capital Movements, for the countries that it would apply to.

A. International Investment Regime

Virtually all emerging economies—with the conspicuous exception of Brazil and some countries that have been trying to pull out lately like South Africa—take part in the international investment regime made out of a network of mainly bilateral investment agreements (BITs or IIAs). The main objective of these agreements is to provide a legal framework to protect foreign investment from political and sovereign risks—such as uncompensated expropriation, discrimination, or restriction on the transfer of funds—by letting investors sue host states before an international tribunal.84 Many IIAs have asset-based definitions of investment that cover all types of cross-border capital transactions, including FDI, loans, and portfolio investment85—which are those that would be covered by an investment screening mechanism designed following the recommendation of the previous chapter.

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With regards to investment screening, three important issues come to mind. First, a decision to block an investment could be seen through the lens of the international investment regime as a violation of national treatment obligations since domestic companies do not have to face these proceedings, if the relevant foreign investor is a national of a country that has an IIA with the country banning the transaction. Second, performance requirements obligations might limit the type of conditions that a host country could impose on foreign investors. Third, an order to divest could be seen as a taking that requires compensation under most IIAs.

As for the first issue, it must be noted that most IIAs only protect investments after they have been admitted to the host state. The question of screening or whether to admit the investment in the first place is not covered in most (especially older) BITs; only post-entry protection is subjected to treaty obligations. To that extent, countries with IIAs drafted in such a way should not face risks of breaching international obligations if they set up an investment screening mechanism that could potentially deny or condition admission to a foreign investment. However, there are two caveats to that conclusion.

First, if the host country utilizes its power to block a transaction by a foreign investor who has already established itself in said country, such decision may potentially fall afoul of the national treatment provisions of its investment treaties. Second, some treaties—notably those where the United States and Canada are signatories—do grant national treatment to pre-investment or investment-making activities. In those cases, foreign investors

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who face negative outcomes from investment reviews could claim a violation of the national treatment obligation, since domestic investors do not face similar restrictions.

As to performance requirement obligations, some IIAs, again most notably those negotiated by the United States, contain performance requirements obligations, which can be defined as disciplines that prohibit host states from imposing conditions on investors that must be fulfilled in order for an investment either to be made in the state or for an advantage to be conferred.\(^9\) For instance, the Investment Chapter of the North America Free Trade Agreement (NAFTA) prohibits parties to impose requirements or enforce any commitment or undertaking related to, inter alia, local content of goods, local services procurement, export performance, export and import targets, technology transfer, and supply of goods and services to specific markets.\(^1\)

To that extent, if an emerging economy impose conditions as the outcome of an investment review that could be interpreted as performance requirements prohibited under its network of IIAs, it might risk to be in breach of its international commitments. In that sense, this kind of obligations might limit the type of conditions that emerging markets authorities could impose through the application of their investment screening framework.

The third issue refers to the cases where the transaction is not blocked in the making, but, after it is done, the government notices that the investment does not behoove its national interest and orders a divestment. In this scenario, the foreign investor—if covered by an IIA—could claim that the measure constitutes an expropriation.\(^2\) Nonetheless, expropriation is not


\(^1\) Article 1106 NAFTA.

unlawful under international law. States have the sovereign right to take over property located in their territory. However, if they decide to do so, they must comply with a set of conditions which, among others, require the provision of just compensation. Since an order to divest implies that the foreign investor would have to sell its interest to, usually, a domestic investor, as long as the agreed price reflects the market value of the investment, the activation of the investment screening mechanism should not raise concerns under the international investment regime. However, if being forced to sell results in a fire-sale, with an extremely discounted price, the investor could claim that it was not properly compensated and request IIA’s protection.

In any case, with regards to IIAs the most important contingency for emerging markets would be related to national treatment commitments and performance requirements obligations. In that sense, states should refrain from granting pre-establishment national treatment or including performance requirements disciplines, and only use their prerogative to block transactions by established foreign investors when it is absolutely necessary. Besides that, emerging markets with investment screening could include textual language clarifying that the investments protected under the IIA shall be made in accordance with the laws and regulations of a contracting party where the investments are made (only post-establishment protection). Alternatively, countries could list investment screening as one of its non-conforming measures with respect to national treatment and performance requirements. This was done by Canada in NAFTA and other IIAs.93

B. GATS

The General Agreement on Trade in Services (GATS) came into force in 1995. Its purpose was to establish a multilateral framework of principles and rules with a view to the expansion of trade in services under the conditions of

93 See: Annex I: Reservations for Existing Measures and Liberalization Commitments, Schedule of Canada NAFTA.
progressive liberalization (GATS Preamble, Rec. 1). At the same time, it recognized the right of Members to regulate in order to meet national policy objectives (GATS Preamble, Rec. 3). The GATS includes four modes of service supply. Mode 3, namely “through commercial presence”, refers to the establishment of a juridical person of a branch for the supply of services in the territory of a member state. To that extent, GATS covers foreign investment in the services sector.\textsuperscript{94}

Two of GATS’ centerpieces of liberalization, namely Articles XVI and XVII, might be relevant when screening foreign investment in the services sector. First, Article XVI, related to market access, list a series of (mostly quantitative) discriminatory or non-discriminatory measures that affect entry and establishment in the market. Second, Article XVII, which contains the national treatment obligation, bans measures that modify the conditions of competition affecting foreign services and service suppliers.\textsuperscript{95}

First off, it is important to bear in mind that both Articles XVI and XVII are found in GATS Part III entitled ‘Specific Commitments’. This reflects the bottom-up approach agreed by negotiators, which means that countries made commitments for the sectors listed in each member’s schedule and subject to the conditions established therein.\textsuperscript{96} The following analysis presumes full liberalization in the sector involving the transaction being screened, however, each country has to assess its individual liberalization position according to its schedule.

Article XVI lists prohibited discriminatory and non-discriminatory measures. More specifically, the measures in question are:

\textsuperscript{94} Muthucumaraswamy Sornarajah, \textit{The International Law on Foreign Investment} (VitalSource Bookshelf). Retrieved from: https://bookshelf.vitalsource.com/#/books/9781108293013/

\textsuperscript{95} Gilles Muller, “Troubled Relationships under the GATS: Tensions between Market Access (Article XVI), National Treatment (Article XVII), and Domestic Regulation (Article VI)”, \textit{World Trade Review} 16: 1-26.

\textsuperscript{96} Muthucumaraswamy Sornarajah, \textit{The International Law on Foreign Investment} (VitalSource Bookshelf). Retrieved from: https://bookshelf.vitalsource.com/#/books/9781108293013/
“quantitative limitations on the number of service suppliers, service operations or quantity of service output, the total value of service transactions, and the total number of natural persons that may be employed in that sector; measures that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service in that sector; and limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment”.\textsuperscript{97}

It is noteworthy that there might be other measures that could limit market access for foreign service suppliers, however, Article XVI only bans the measures listed in its second paragraph. To that extent, countries might have to bear in mind that the conditions that they impose through investment review can be at odds with this provision. For instance, when conditioning the admission of a transaction, countries might have to refrain demanding the reduction of the participation of the foreign investment in a domestic company or the establishment of a joint venture with a local partner, since those are some of the measures banned by Article XVI of the GATS.

Now, investment screening could also be challenged through the national treatment obligation enshrined in Article XVII of the GATS. This provision mandates Members to accord foreign services and service suppliers ‘treatment no less favorable than it accords to its own like services and service suppliers’. Moreover, paragraph 3 of the mentioned Article specifies that a measure breaches national treatment obligation “if it modifies the conditions of competition in favor of services and service suppliers of the Member compared to like services and service suppliers of any other Member”. Some scholars have argued that WTO members may not subject foreign investor to particular authorization requirements, if an equivalent authorization is not requested to their nationals, since such proceeding

\textsuperscript{97} WTO. Modalities for Pre-establishment Commitments Based on a GATS-Type, Positive List Approach, WT/WGTI/W/120. Geneva: 2002.
modifies the conditions of competition in favor of domestic suppliers.\textsuperscript{98} Other authors consider that subjecting foreign investors in the services sector to review does not necessarily imply a national treatment violation, but countries could breach said obligation if, through this policy tool, they impose conditions that are not required for domestic service suppliers.\textsuperscript{99}

In a word, countries should be wary of their liberalization of trade in services commitments, as reflected in their GATS schedules, if they are reviewing investments in the services sector to prevent any potential inconsistency with their national treatment obligations. In addition, following Article XXI of the GATS, an emerging market economy putting in place an investment screening mechanism could modify its schedule—compensation might be requested, but it is unlikely, given that several developed countries screen investment. In that sense, the relevant country would include its screening legislation in its GATS schedule as a reservation under national treatment and market access. Ideally, this should be done on the horizontal section so it applies across all sectors. An example can be found, again, in Canada’s schedule of commitments which on the market access column of the horizontal section for commercial presence clarifies that:

“The acquisition of control of a Canadian business by a non-Canadian is subject to approval for all direct acquisitions of Canadian businesses with assets not less than a monetary amount established and published in January of each year in the Canada Gazette”.\textsuperscript{100}

\begin{footnotes}
\footnote{\textsuperscript{98} Martin Molinuevo, “WTO Disciplines on Foreign Investment Wasn’t the GATS about trade in services?”, Universidad de Bolonia, 
\url{http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.470.8663&rep=rep1&type=pdf}
P. 69}
\footnote{\textsuperscript{100} Canada’s Schedules of Specific Commitments to GATS, GATS/SC/16, 15 April 1994.}
\end{footnotes}
C. TRIMs Agreement

The Agreement on Trade-Related Investment Measures (TRIMs Agreement) deals with investment measures that affect international trade in goods. Basically, it provides that TRIMs cannot discriminate against foreign products or lead to the imposition of quantitative restrictions. In that sense, this agreement provides that WTO Members’ regulations dealing with foreign investments must respect the obligations in Article III (national treatment) and Article XI (prohibition on quantitative restrictions) of the GATT 1994.\textsuperscript{101}

The Annex to the TRIMs Agreement provides an illustrative list of the kind of measures that would be inconsistent with either Article III or Article XI of the GATT and, consequently, cannot be adopted by WTO Members. Particularly, the TRIMs Agreement forbids:

- Local content requirements for goods
- Limitations to the purchase or use of imported products with regards to the purchase or use of domestic products
- Restrictions to the amount of imports
- Restrictions on access to foreign exchange
- Restriction on the export of local goods

To that extent, emerging economies that wish to adopt investment screening mechanisms should refrain to include these kind of measures as conditions for the authorization of an investment proposal, since such requirements would be inconsistent with their obligations under the GATT and the TRIMs Agreement.

There are noteworthy precedents of how conditions arising from investment review proceedings can be inconsistent with the GATT, if they contain the type of requirements listed in the Annex to the TRIMs Agreement. In 1982, the United States initiated the GATT dispute resolution system to challenge Canada for its administration of the Foreign Investment Review Act,\textsuperscript{101}

since it imposed requirements to purchase Canadian goods or goods from Canadian suppliers and/or export goods from Canada, within the investment screening process. The panel, after assessing the facts and the arguments of the parties, considered that the requirements to purchase Canadian goods or goods from Canadian suppliers were inconsistent with Article III.4 of the GATT, since these measures gave less favorable treatment to foreign goods compared to domestic ones.\textsuperscript{102} It must be highlighted that the fact that some of these requirements came as undertakings proposed by investors was not enough for the panel to be convinced by Canada’s argument that they were not regulations within the meaning of Article III.

Thereafter, the WTO adjudicating bodies have rules in a long line of cases that trade balancing and local content requirements are inconsistent with the TRIMs Agreements and the GATT.\textsuperscript{103} Despite none of these cases dealt with conditions arising from investment screening procedures, they are proof of the importance of being mindful of this agreement when adopting conditions that might affect trade in goods.

D. The OECD Code of Liberalization of Capital Movements

One of the internationally binding instruments that promotes liberalization of capital movements, in spite of not been widely known, is the OECD Code of Liberalization of Capital Movements (CLCM). While this is not a multilateral instrument binding for most emerging economies, it is important to note that in recent years some Latin American emerging economies have joined the organization. Specifically, Mexico (1994), Chile (2010) and Colombia (2020) have become members of what is known as the club of mostly rich

\textsuperscript{102} GATT Panel Report, Canada – Administration of the Foreign Investment Act (L/5504 – 30S/140), 7 February 1984.

\textsuperscript{103} Most recently, see: India – Certain Measures Relating to Solar Cells and Solar Modules, DS456.
countries.\textsuperscript{104} Turkey has also been part of the organization since 1961. Other relevant countries such as Brazil, Peru, Bulgaria, South Africa, Rumania, Argentina and Costa Rica have manifested their interest to adhere to the CLMC.\textsuperscript{105} To that extent, evaluating the scope and reach of the obligations undertaken under the CLMC is relevant for emerging markets that are currently bound by this legal instrument, but also for those that are considering or might consider adhering to the Code and who would be also interested in setting up investment screening mechanisms.

The CLCM main objective is the progressive elimination of restrictions on capital movements between its adherents. Specifically, Article 1 of the Code states: “Members shall progressively abolish between one another, in accordance with the provisions of Article 2, restrictions on movements of capital to the extent necessary for effective economic co-operation”.

According to the OECD Codes of Liberalization User's Guide: “Any law, decree, regulation, policy and practice taken by the authorities which may restrict the conclusion or execution of operations covered by the Codes constitutes a restriction”.\textsuperscript{106} Moreover, measures that do not prevent operations, but raise their effective cost are deemed as equivalent measures to restrictions and should also be eliminated.\textsuperscript{107}

This instrument has a wide scope, since it comprises the full range of international capital movements. However, the elimination of restrictions with regard to those operations is uneven. Each country has a list with reservations stating the restrictions that it wishes to maintain for the time being. Moreover, categories of capital movement are divided into two lists: A and B. The operations enounced in List A are subject to the standstill principle, i.e., a country can only lodge reservations concerning those

\textsuperscript{104}OECD. “Member countries”, https://www.oecd.org/about/members-and-partners/
transactions when it adheres to the Code. Conversely, as to operations comprised in List B, adherents can always lodge reservations.

Table 7. Operations covered by the CLCM

<table>
<thead>
<tr>
<th>LIST A</th>
<th>LIST B</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Standstill” applies to these operations (ie. derogation needed to reintroduce restrictions)</td>
<td>No “standstill” applies to these operations</td>
</tr>
<tr>
<td>I. Direct investment</td>
<td></td>
</tr>
<tr>
<td>II. Liquidation of direct investment</td>
<td>III. Real estate - Purchase</td>
</tr>
<tr>
<td>IV. Operations in securities on capital markets</td>
<td>V. Operations on money markets</td>
</tr>
<tr>
<td>VII. Collective investment securities</td>
<td>VI. Negotiable instruments and non-securitised claims</td>
</tr>
<tr>
<td>VIII. Credits directly linked with international commercial transactions or rendering of International services In cases where a resident participates in the underlying commercial or service transaction</td>
<td>VII. Credits directly linked with international commercial transactions or rendering of International services In cases where no resident participates in the underlying commercial or service transaction</td>
</tr>
<tr>
<td>IX. Financial credits and loans</td>
<td></td>
</tr>
<tr>
<td>X. Sureties, guarantees and financial back-up facilities (see List B)</td>
<td>X. Financial back-up facilities in cases not directly related to international trade, international current invisible operations or international capital movement operations, or where no resident participates in the underlying international operation concerned</td>
</tr>
<tr>
<td>XI. Operation of deposit accounts by non-residents of accounts with resident institutions</td>
<td>XI. Operation of deposit accounts by residents of accounts with non-resident institutions</td>
</tr>
<tr>
<td>XIII. Life assurance</td>
<td>XII. Operations in foreign exchange</td>
</tr>
<tr>
<td>XIV. Personal capital movements except Gaming</td>
<td>XIV. Personal capital movements Gaming</td>
</tr>
<tr>
<td>XV. Physical movement of capital assets</td>
<td></td>
</tr>
<tr>
<td>XVI. Disposal of non-resident-owned blocked funds</td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD.¹⁰⁸

Notably, inward direct investment, commercial credits, and operations in securities on capital markets (portfolio investment) are classified as List A items. Since these are the kind of operations that would be subject to investment screening according to the recommendations sketched in the last

section, it must be noted that current OECD Members cannot lodge new reservations to prevent inconsistencies, if these kind of mechanisms are deemed to be restrictions in the sense of Article 2 of the CLCM.

According to the User’s Guide: “Measures such as screening procedures or registration requirements are not considered restrictions, if they do not affect the effective carrying out of the operation”. Given that the investment screening mechanism proposed in the previous section could block transactions or raise the cost of an investment through conditioning, it is feasible that it would be deemed a measure that constitutes a restriction under the CLCM.

The latter has different consequences for each country. For instance, Chile has not lodged reservations concerning investment screening with regard to inward direct investment, operation in securities on capital markets and commercial credits. To that extent, if it puts in place an investment screening mechanism that could restrict capital flows from other OECD Members, it could be breaching its obligations under the CLCM.

Now, concerning emerging markets intending to adhere to the CLCM and considering putting in place an investment screening mechanism, the situation is different. They could lodge reservations concerning the mentioned items, stating that they reserve the right to screen foreign investment and condition it or block if it does not meet the requirements laid down in the domestic regulation. This precaution would preclude the possibility of an international wrongful act.

\[109\] Ibid em.
6. Conclusion

For a long time, developing countries had a hostile position with respect to foreign investment. As a part of their nationalist development strategies, they imposed all types of FDI restrictions and capital controls. Starting in the 1980s foreign investment started to be perceived as a positive input in a country’s economy, as it increases the amount of capital available to finance productive activities. The change of paradigm led to a rapid liberalization of inward foreign direct investment, and also portfolio, in most developing countries. In a sense, the birth of the notion emerging market is tied to the increase of foreign investment directed to a set of developing countries starting in the 1990s.

However, more recently governments, international organizations, and diverse stakeholders have recognized that capital inflows into a country are not without harm or peril. Recently, emerging market economies have faced an influx of foreign capital that lacks transparency, accountability, and market orientation flowing from authoritarian regimes into new and transitioning democracies, i.e., corrosive capital. In addition, also in recent years, emerging market economies’ governments, international organizations and scholars have inquired about the characteristics that foreign investment should have to contribute to the sustainable development of host states. Moreover, they have recognized that different types of capital have different economic, social, and environmental consequences.

Investment screening mechanisms in emerging market economies could become a pivotal policy tool to generate synergies between private and public sector to enhance the contribution of foreign investment to fulfil policy goals, while controlling the entry of corrosive capital into the economy.

The ‘national interest’ notion could be used by emerging markets wishing to deploy investment screening mechanisms with the objective of blocking or conditioning corrosive capital, while not deterring the entry of constructive capital that would further sustainable development.

In their attempt to do so, emerging markets must bear in mind their international obligations. Concerning the international investment regime,
they should endeavor to exclude pre-establishment national treatment and performance requirements commitments in their international investment agreements or, at least, carve-out their investment screening legislation as non-conforming measures. With regard to the WTO, an investment screening mechanism should be applied with special caution concerning transaction related to the services sector, considering the specific commitments made by each country within the GATS—or countries might want to modify their schedules to reserve their right to screen investment—and must not impose conditions deemed inconsistent with national treatment obligations specified in the TRIMs Agreement, such as local content requirements for goods. Finally, if a country is considering adhering to the OECD Code of Liberalization of Capital Movements, it might try to lodge a reservation stating that it will conduct investment screening.

All in all, investment review could be a powerful policy tool for emerging economies to maximize the contribution that international investment generates in their markets.
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