

GAO

Report to the Honorable Richard
Shelby, Ranking Member, Committee
on Banking, Housing, and Urban
Affairs, U.S. Senate

February 2008

FOREIGN INVESTMENT

Laws and Policies Regulating Foreign Investment in 10 Countries





Highlights of [GAO-08-320](#), a report to the Honorable Richard Shelby, Ranking Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

Why GAO Did This Study

Foreign acquisitions of U.S. companies can pose a significant challenge for the U.S. government because of the need to balance the benefits of foreign investment with national security concerns. The Exon-Florio amendment to the Defense Production Act authorizes the President to suspend or prohibit foreign acquisitions of U.S. companies that may harm national security.

To better understand how other countries deal with similar challenges, GAO was asked to identify how other countries address the issues that Exon-Florio is intended to address. Specifically, this report describes selected countries' (1) laws and policies enacted to regulate foreign investment to protect their national security interests and (2) implementation of those laws and policies.

This report updates a 1996 GAO report that describes how four major foreign investors in the United States—France, Germany, Japan, and the United Kingdom—monitored foreign investment in their own countries to protect national security interests. It also examines foreign investment in six additional countries: Canada, China, India, the Netherlands, Russia, and the United Arab Emirates (UAE). GAO reviewed selected laws and regulations and interviewed foreign government officials and others concerning their implementation and any planned changes to their foreign investment laws, regulations, and policies.

To view the full product, including the scope and methodology, click on [GAO-08-320](#). For more information, contact Ann Calvaresi-Barr at (202) 512-4841 or calvaresibarra@gao.gov.

FOREIGN INVESTMENT

Laws and Policies Regulating Foreign Investment in 10 Countries

What GAO Found

As is the case in the United States, the countries we reviewed have enacted laws and instituted policies regulating foreign investment, often to address national security concerns. However, each of the 10 countries has its own concept of national security that influences which particular investments may be restricted. As a result of the differing concepts, restrictions range from requiring approval of investments in a narrowly defined defense sector to broad restrictions on the basis of economic security and cultural policy. In addition, some countries have recently made changes to their laws and policies to more explicitly identify national security as an area of concern, in some cases as the result of controversial investments. Several countries have also introduced lists of strategic sectors in which foreign investment requires government review and approval.

While there are many unique characteristics of the systems employed by the 10 countries to regulate foreign investment, in many ways the systems are similar to each other, and to the U.S. process under Exon-Florio. Eight countries use a formal review process—usually conducted by a government economic body with input from government security bodies—to review a transaction. Generally, national security is a primary factor or one of several factors considered in evaluating transactions. While the concepts of national security vary from country to country, all countries share concerns about a core set of issues. These include, for example, the defense industrial base, and more recently, investment in the energy sector and investment by state-owned enterprises and sovereign wealth funds. Most countries have established time frames for the review and can place conditions on transactions prior to approval. For example, a country may place national citizenship requirements on company board members.

However, unlike the voluntary notification under Exon-Florio, most countries' reviews are mandatory if the investment reaches certain dollar thresholds or if the buyer will obtain a controlling or blocking share in the acquired company. Further, unlike the United States, five countries allow decisions to be appealed through administrative means or in court.

Two countries do not have a formal review process. The Netherlands restricts entry into certain sectors such as public utilities, and the UAE restricts the extent of ownership allowed in all sectors without a review. In addition to the formal mechanisms, there are unofficial factors that may influence investment in each of the 10 countries. For example, in some countries an informal government preapproval for sensitive transactions may be needed.

In commenting on a draft of this report, the Department of the Treasury emphasized the United States' commitment to an open investment policy.

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Abbreviations

CFIUS	Committee on Foreign Investment in the United States
DBERR	Department of Business, Enterprise, and Regulatory Reform
DIPP	Department of Industrial Policy and Promotion
EC	European Community
ECJ	European Court of Justice
EU	European Union
FAS	Federal Anti-Monopoly Service
FDI	foreign direct investment
FEFTA	Foreign Exchange and Foreign Trade Act
FEMA	Foreign Exchange Management Act
FERA	Foreign Exchange Regulation Act
FINSA	Foreign Investment and National Security Act
FIPB	Foreign Investment Promotion Board
FTZ	free trade zone
GDP	gross domestic product
ICA	Investment Canada Act
IMF	International Monetary Fund
IPO	initial public offering
METI	Ministry for Economy, Trade, and Industry
MOFCOM	Ministry of Commerce
NAFTA	North American Free Trade Agreement
NDRC	National Development and Reform Commission
NSEA	National Security Exception Act
OECD	Organization for Economic Co-operation and Development
OFT	Office of Fair Trading
SAIC	State Administration for Industry and Commerce
SASC	State-owned Assets Supervision and Administration Commission
SOE	state-owned enterprise
UAE	United Arab Emirates
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

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United States Government Accountability Office
Washington, DC 20548

February 28, 2008

The Honorable Richard Shelby
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate

U.S. investment policy is anchored in the belief that global investment is beneficial and necessary to bring economic prosperity worldwide. The United Nations reported that between 2000 and 2006, annual foreign direct investment in the United States averaged \$144 billion, which is 16 percent of the world's total during that period. The Deputy Secretary of the Treasury testified in 2005 that there is an inherent link between our national security interests and a strong U.S. economy that facilitates free and fair trade.¹ However, foreign acquisitions of U.S. companies can pose a significant challenge for the U.S. government because of the need to balance the benefits of foreign investment with national security concerns. The Exon-Florio amendment to the Defense Production Act authorizes the President to suspend or prohibit transactions that could result in foreign control of U.S. companies² if the transaction threatens to impair national security.³ The review of individual transactions has been delegated to an interagency committee, the Committee on Foreign Investment in the United States (CFIUS). In July 2007, the Foreign Investment and National Security Act of 2007⁴ amended Exon-Florio to, among other things, expand the factors to be considered in deciding what could affect national security and bring greater transparency to the CFIUS review process.⁵

¹ Testimony of Deputy Secretary Robert M. Kimmitt, U.S. Department of the Treasury, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, October 20, 2005.

² By "U. S. companies" we mean companies engaged in interstate commerce in the United States.

³ Omnibus Trade and Competitiveness Act of 1988 § 5021, Pub. L. No. 100-418, 102 Stat. 1107 (1988) (codified at 50 U.S.C. App. § 2170).

⁴ Pub. L. No. 110-49 (2007).

⁵ The Foreign Investment and National Security Act of 2007 became effective on October 24, 2007.

To better understand how other countries deal with similar challenges, you asked us to identify other countries' approaches for addressing the issues that Exon-Florio is intended to address. Specifically, this report describes selected countries' (1) laws and policies enacted to regulate foreign investment to protect their national security interests and (2) implementation of those laws and policies.

The Government Accountability Office has reported on the implementation of Exon-Florio dating back to the 1990s.⁶ In addition, in 1996 we issued a report that describes how four major investors in the United States—France, Germany, Japan, and the United Kingdom—monitored foreign investment in their own countries to protect national security-related interests.⁷ This report updates the 1996 report and also expands it by describing foreign direct investment policies and processes in six additional countries: Canada, China, India, the Netherlands, Russia, and the United Arab Emirates (UAE). Appendixes IV–XIII contain country-specific information for each of the 10 countries. Our selection of the countries was based on a number of factors: We chose countries with which the United States has a large reciprocal investment relationship, countries with diverse investment controls, countries chosen for regional diversity, and those selected in prior GAO work. We obtained and reviewed copies of relevant laws and regulations and interviewed foreign government officials concerning their implementation and any planned changes to their foreign investment laws, regulations, and policies. The information on foreign laws and regulations in this report does not reflect our independent legal analysis, but is based on interviews and secondary sources such as analysis by foreign law specialists at the U.S. Library of Congress and our review of the laws in the original language, or translated copies of the various foreign laws obtained from foreign government officials, foreign government Web sites, or U.S. State Department sources. We also interviewed law firms and companies that had been involved in merger and acquisition activities in the countries in our sample. For a complete description of our scope and methodology, see appendix I.

⁶ GAO, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, [GAO-05-686](#) (Washington, D.C.: Sept. 28, 2005); *Defense Trade: Mitigating National Security Concerns under Exon-Florio Could Be Improved*, [GAO-02-736](#) (Washington, D.C.: Sept. 12, 2002); *Defense Trade: Identifying Foreign Acquisitions Affecting National Security Can Be Improved*, [GAO/NSIAD-00-144](#) (Washington, D.C.: June 29, 2000).

⁷ GAO, *Foreign Investment: Foreign Laws and Policies Addressing National Security Concerns*, [GAO/NSIAD-96-61](#) (Washington, D.C.: Apr. 2, 1996).

We conducted this performance audit from December 2006 to February 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

As is the case in the United States, the countries we reviewed have enacted laws and instituted policies regulating foreign investment, often to address national security concerns. However, each of the 10 countries has its own concept of national security that influences which particular investments may be restricted. As a result of the differing concepts, restrictions range from requiring approval of investments in a narrowly defined defense sector to broad restrictions on the basis of economic security and cultural policy. In addition, some countries have recently made changes to their laws and policies to more explicitly emphasize national security concerns, in some cases as the result of controversial investments. Several countries have also introduced lists of strategic sectors in which foreign investment requires government review and approval.

While there are many unique characteristics of the systems employed by the 10 countries to regulate foreign investment, in many ways the systems are similar to each other, and in several ways similar to the U.S. process under Exon-Florio. Eight countries use a formal review process—usually conducted by a government economic body with input from government security bodies—to review a transaction. Generally, national security is a primary factor or one of several factors considered in evaluating transactions. While the concepts of national security vary from country to country, all countries share concerns about a core set of national security issues. These include, for example, the defense industrial base, and more recently, investment in the energy sector and investment by state-owned enterprises and sovereign wealth funds.⁸ Most countries have established time frames for the review and can place conditions on selected transactions prior to approval. For example, a country may place national

⁸ Sovereign wealth funds are entities that can manage national savings for the purposes of investment. These funds may be similar in their investment behavior to other forms of investment funds, such as private equity funds. However, they fundamentally differ in that they are not privately owned.

citizenship requirements on company board members. However, unlike the voluntary notification under Exon-Florio, most countries' reviews are mandatory if the investment reaches certain dollar thresholds or if the buyer will obtain a controlling or blocking share in the acquired company. Further, unlike in the U.S. process, five countries allow decisions to be appealed in court or through administrative means. Two countries do not have a formal review process. The Netherlands restricts entry into certain sectors such as public utilities, and the UAE restricts the extent of ownership allowed in all sectors without a review. In addition to the formal mechanisms, there are unofficial factors that may influence investment in each of the 10 countries. For example, in some countries it may be necessary to obtain an informal government preapproval for sensitive transactions.

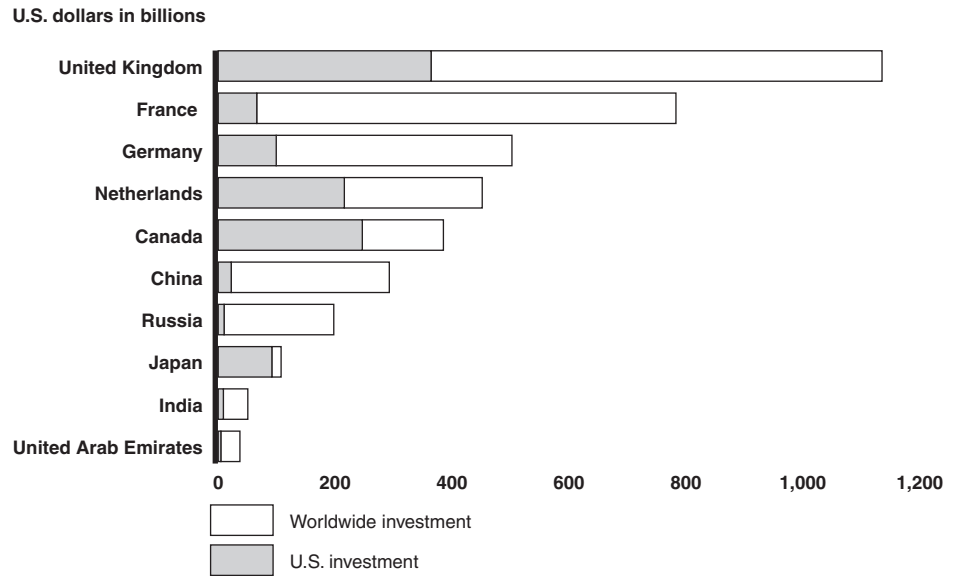
The Department of the Treasury (Treasury) provided written comments on a draft of this report. Treasury emphasized the commitment of the United States to an open investment policy and stated that countries' general investment policies and the relationship of foreign investment reviews to those policies are important in understanding investment review regimes. Agency comments are included in their entirety in appendix II of this report.

Background

The United States is the main source of foreign direct investment and also the leading host country for foreign direct investment (FDI).⁹ The top three destinations for U.S. foreign direct investment, cumulatively as of 2006, were the United Kingdom, Canada, and the Netherlands. The top three foreign direct investors into the United States, cumulatively as of 2006, were the United Kingdom, Japan, and Germany. Figure 1 shows the amount of foreign direct investment from the United States into the countries we reviewed and the amount of worldwide investment into these countries, cumulatively as of 2006.

⁹ In this report, we use the term "foreign investment" to refer to foreign direct investment, specifically mergers and acquisitions, because Exon-Florio governs foreign direct investment via mergers, acquisitions, and takeovers in the United States, and this law is the basis of our work.

Figure 1: U.S. and Worldwide Foreign Direct Investment Stocks in the 10 Selected Countries as of 2006



Source: U.S. Department of Commerce, Bureau of Economic Analysis (U.S. investment); and United Nations Conference on Trade and Development (worldwide investment).

Foreign direct investment is defined as the purchase of real assets abroad for the purpose of acquiring a lasting interest in an enterprise and exerting a degree of influence on that enterprise’s operations.¹⁰ There are several different kinds of foreign direct investment, including the following:

Greenfield investments: A greenfield investment is the investment in a physical structure in an area where no corporate facilities previously existed. It normally entails complete ownership and therefore full control over management.

Strategic partnerships: A strategic partnership is a formal alliance (joint venture, licensing agreement, distributorship, or agency contract) between two commercial enterprises, usually formalized by one or more business

¹⁰ Foreign direct investment is measured in both stocks and flows. Foreign direct investment stocks are data showing an economy’s cumulative direct investment assets and liabilities at a given point in time. The stock of foreign direct investment results from an accumulation of flows. Foreign direct investment flows are transactions between an investor in one economy and an enterprise in another economy that occurred during a specific time period.

contracts, where they mutually participate in certain activities (advertising, branding, product development, etc.).

Mergers and acquisitions: A merger is a business event wherein two or more companies decide to pool their assets to form a single new company. In the course of this transaction, one of the previously existing companies ceases to exist. An acquisition does not necessarily constitute a merger if the preexisting companies continue to exist. Both of these business transactions can result in a foreign entity gaining a portion of a domestic entity.

The Committee on Foreign Investment in the United States

The Exon-Florio amendment authorizes the President to suspend or prohibit foreign acquisitions of U.S. companies if they are determined to pose a threat to national security. The President delegated the authority to investigate individual transactions to an interagency committee, the Committee on Foreign Investment in the United States.¹¹ While application to CFIUS for review is voluntary, firms subject to an Exon-Florio review that do not notify CFIUS remain indefinitely subject to Exon-Florio and appropriate actions by the President. However, Exon-Florio applies only when a transaction is related to national security, which is the case in a small percentage of the overall number of foreign direct investments in the United States. According to the Treasury Department, historically less than 10 percent of foreign direct investments in U.S. companies were reviewed by CFIUS. For example, in 2006, there were approximately 1,730 transactions of foreign companies acquiring U.S. companies. In the same year, CFIUS received 113 notices, or 6.5 percent of the total transactions for 2006. Seven of those notices proceeded to a 45-day investigation and none of them were prohibited. In 2007, CFIUS received 147 notices. Of these 147 notices, 6 proceeded to a 45-day investigation and none were prohibited.¹²

Particular transactions may be approved by CFIUS without conditions, or may be approved on the condition that the investor adheres to certain mitigation agreements. The President can, based on the advice of the

¹¹ Subsequently the Foreign Investment and National Security Act of 2007 statutorily established CFIUS and its membership.

¹² The number of notices received by CFIUS in 2006 and 2007 slightly exceeded the number of distinct transactions reviewed because several cases were terminated prior to completion of a review, either because of withdrawal or dismissal for lack of jurisdiction.

committee, exercise his authority under the Exon-Florio provision to suspend or prohibit a foreign acquisition of a U.S. company only if he finds that there is credible evidence that the foreign entity exercising control might take action that threatens national security, and that laws, other than Exon-Florio and the International Emergency Economic Powers Act, do not provide adequate and appropriate authority to protect national security.¹³ On July 26, 2007, the Foreign Investment and National Security Act of 2007 was passed, amending Exon-Florio. The act addressed some of the issues related to the protection of national security interests. See appendix III for a summary of the changes.

Foreign Investment Laws, Policies, and Processes Address National Security Concerns

As is the case in the United States, each of the countries we reviewed has enacted laws and instituted policies regulating foreign investment—often to address national security concerns. History and each country’s experience with foreign investment have influenced its concept of national security, which in turn influences restrictions placed on investments. For example, foreign investment policies can be affected by the specific legal system under which the country operates, and the length of time the country has adhered to a market-based economic system. Restrictions range from requiring approval of investments in a narrowly defined defense sector to broad restrictions on the basis of economic security and cultural policy. Recent and proposed changes in the countries’ laws and policies have more explicitly identified national security as an area of concern, in some cases as the result of controversial investments.

Various Legal Means Exist to Regulate Foreign Direct Investment

Similar to the United States, the countries we studied generally have laws and regulations that restrict foreign investment based on national security, though the scope of that authority varies significantly. See table 1 for the relevant laws by country and the stated reasons for the restrictions.

¹³ The International Emergency Economic Powers Act allows the President to declare a national emergency to deal with extraordinary threats to national security or the economy. 50 U.S.C. §§ 1701–1706.

Table 1: Selected Laws and Regulations Addressing Foreign Investment Restrictions

Country	Laws and regulations	Reasons for review or restrictions
Canada	Investment Canada Act, 1985	To ensure net benefit to Canada
China	2006 Regulations for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Catalog for the Guidance of Foreign Investment Industries	National economic security, protection of critical industries, purchase of famous trademarks or traditional Chinese brands
France	Law 2004-1343, Decree 2005-1739	Public order, public safety, national defense
Germany	2004 Amendment to 1961 Foreign Trade and Payments Act	Ensure essential security interests, prevent disturbance of peaceful international coexistence or foreign relations
India	Foreign Exchange Management Act, 1999	National security and domestic, cultural, and economic concerns
Japan	1991 Amendment to the Foreign Exchange and Foreign Trade Act of 1949	National security, public order, public safety, or the economy
The Netherlands	Financial Supervision Act of 2006	Competition, financial market oversight
Russia	1999 Federal Law on Foreign Investments	Protection of foundations of the constitutional order, national defense and state security, anti-monopoly
United Arab Emirates	Agencies Law of 1981, Companies Law of 1984	Economic and demographic concerns
United Kingdom	Enterprise Act of 2002	Public interest, control of classified and sensitive technology
United States	Exon-Florio Amendment to the Defense Production Act of 1950, as amended	National security

Source: GAO summary and analysis of laws and information obtained as described in our scope and methodology. See appendix I.

The two countries without a review process, the Netherlands and the UAE, restrict entry into certain sectors or restrict the extent of ownership allowed in a sector. However, their investment policies are significantly different. The Dutch law does not restrict foreign investment for national security. Other than the Dutch Central Bank’s capability through the Financial Supervision Act to block financial sector acquisitions, the country has few restrictions on foreign investment. The UAE maintains an ownership limit of 49 percent on foreign investment in every sector through its Companies Law. According to U.S. and UAE government officials, the restrictions were primarily designed to ensure that UAE

citizens are beneficiaries of the country's economic growth, since a majority of residents and private sector employees are not UAE citizens. These restrictions can also be used to protect the country's national security interests.

Historical Factors Affect a Country's Receptiveness to Foreign Investment

The approach to foreign investment that each country in our review has taken is based in part on the structure of its legal system, its history, and economy. For example, the laws regulating investment in countries that operate under a common law system tended to be less specific and less detailed than the laws and policies of countries that operate under a civil law system. More specifically, in a common law system, case law determines the scope and intent of a given law. In contrast, civil law systems are, in general, based on a systematic codification of the law. In civil law systems, case law formally plays a minor role compared to the status of the civil code. Finally, some countries' laws do not fit into the single category of civil or common law system. Instead, these countries' utilize more than one legal system, and therefore can be described as mixed. Table 2 categorizes the different legal systems under which the selected countries operate.

Table 2: Legal Systems of Selected Countries

Country	Type of system
Canada	Mixed: primarily common law and some civil law
China	Mixed: civil law, communist legal system, and traditional Chinese law
France	Civil law
Germany	Civil law
India	Common law
Japan	Civil law
The Netherlands	Civil law
Russia	Civil law
United Arab Emirates	Mixed: Islamic and civil law
United Kingdom	Common law

Source: U.S. Library of Congress.

In addition to the impact of various legal systems, in the late 20th century, several countries began to transition from centrally controlled to market-based economies. As this occurred, previously state-owned enterprises

have been privatized. A country's experience with privatization can affect its view of foreign investment.

Recent Changes More Explicitly Emphasize National Security Concerns

Recent changes to foreign investment laws and policies have in some cases subjected foreign investment to greater scrutiny. Specifically, each country has changed or considered changing its foreign investment laws, policies, or processes in the last 4 years; many of the changes demonstrate an increased emphasis on national security concerns. In some cases, specific transactions were catalysts in the reconsideration of policies and the development of new ones. However, according to government officials in several countries, these changes simply codified and made more transparent prevailing practices.

Canada

The Investment Canada Act provides for a transparent foreign investment review process.¹⁴ All transactions above designated dollar thresholds are to be reviewed and approved by either the Minister of Industry or the Minister of Canadian Heritage. The act currently does not require a review based on national security. Instead, the review process considers economic factors and cultural policy objectives. In June 2005, the Canadian government introduced a bill to amend the foreign investment review process that included provisions to allow the government to review foreign investment based on national security concerns.¹⁵ However, the 38th Parliament was dissolved at the end of 2005 to prepare for the 2006 election, and the bill was never passed.

In July 2007, the Canadian government created a Competition Policy Review Panel to review key elements of Canada's competition and investment policies, including the Investment Canada Act, which will be updated as a result of the panel's review. The panel is expected to provide its recommendations to the Minister of Industry by the end of June 2008. The government of Canada is also examining the need for a mechanism to screen foreign investment on the basis of national security.

China

The Chinese political-legal system exerts a wide range of controls over foreign direct investment and restricts or prohibits foreign investment in targeted industries via an ad hoc and opaque system of laws, regulations, and policies, according to the U.S. Library of Congress and officials

¹⁴ Investment Canada Act, June, 20, 1985.

¹⁵ Bill C-59, an Act to Amend the Investment Canada Act, First Reading, June 20, 2005.

familiar with foreign investment in China. In 2005, a U.S. private equity firm's attempt to purchase 85 percent ownership of a Chinese state-owned company that manufactured construction equipment led to a public outcry against foreign acquisitions in China. Beginning in 2006, China revised its foreign investment regulations to introduce a new "national economic security" screening requirement for cross-border mergers and acquisitions. The Chinese government also introduced a list of seven specific sectors deemed critical to the national economy,¹⁶ a new 5-year plan for utilizing foreign investment that promised a fundamental shift from "quantity" to "quality" in foreign investment, and new provisions on the acquisition of domestic enterprises by foreign investors. The new regulations were released by six government agencies, led by the Ministry of Commerce.

France

In 2000, the European Court of Justice ruled that France had contravened European Community law by prohibiting an investment in France. The European Court of Justice ruled that France should clarify its investment restrictions. As a result, France enacted Law 2004-1343 in 2004, reforming the foreign investment review process. An accompanying Ministerial Decree, issued in 2005, identifies 11 sectors of the economy that require the prior approval of the French Ministry of Economy, Finance, and Employment when foreign investors seek to obtain a controlling share or a specified portion of a French company.¹⁷ In October 2006, the European Commission formally asked France to amend its regulations. As of February 2008, France has made proposals to address the European Commission concerns, and discussions are ongoing.

Germany

The German Foreign Trade and Payments Act, which regulates foreign investment, was amended in 2004 after a U.S. company bought a controlling share of a German submarine manufacturer. The amendments tightened regulations regarding the foreign ownership of defense-related enterprises. Under the new regulations, the acquisition of more than 25 percent of the voting rights of a German company producing armaments, ammunition, cryptographic equipment, or engines and gear systems for tanks or other armored military tracked vehicles is subject to

¹⁶ The seven sectors identified as critical are defense, power generation and distribution, oil and petrochemical, telecommunications, coal, aviation, and shipping. In addition, sectors have been identified in which the government should maintain control: equipment manufacturing, automotive, electronic information, construction, iron and steel, nonferrous metal, chemical, survey and design, and science and technology.

¹⁷ See appendix VI for a list of the 11 sectors.

review. Germany is currently considering further changes to the law to address the national security implications of investments by sovereign wealth funds because of concerns that they may be driven by political rather than economic reasons.

India

In India, foreign investment in some sectors, including retail and atomic energy, are prohibited. Foreign investment in other sectors, including defense, insurance, and print media, is limited. Investments in specified industries including aerospace and explosives must receive an industrial license and approval from the Foreign Investment Promotion Board. Frequent changes to restrictions in individual sectors are common. Recent changes in Indian investment policy have focused on liberalizing the limits on the percentage of foreign ownership. For example, in April 2007, India finalized changes to restrictions on foreign investment in the telecommunications sector, raising the ownership cap from 49 percent to 74 percent. In January 2008, the government approved additional changes in other sectors, increasing the limit on foreign investment in petroleum refining, some parts of the civil aviation sector, and several other sectors. However, according to an Indian government official, the liberalization and privatization of domestic investment have had a bigger impact on the Indian economy than foreign investment. In addition to making changes to various sector-specific foreign investment restrictions, the Indian government has also recently considered implementing a national security-based review process. The National Security Council Secretariat suggested a new law—the National Security Exception Act—that would have established a process for assessing security threats related to foreign investment, similar to the process used by CFIUS. Although the act met resistance from the Ministries of Commerce and Finance and was subsequently abandoned, India is still debating the need for a national security review of foreign investment.

Japan

Under the Japanese Foreign Exchange and Foreign Trade Act, a foreign investor is required to notify the government in advance if it intends to invest in sensitive industries, including those related to national security. The transaction is then reviewed to determine whether it might imperil national security, disturb public order or public safety, or adversely affect the Japanese economy. In September 2007, the government instituted changes to foreign investment policies in Japan. The primary change is that foreign investment in industries with dual use technologies is now subject to prior notification and a government review. This change is intended to prevent the outflow of technology, with a focus on items that have a high probability of conversion to use in weapons of mass destruction and items that are used to maintain the defense production

and technology infrastructure. The revisions include a list of all specific industries and items that fall under the new prior notification requirements, including accessories, components, and equipment related to weapons manufacturing.

Russia

The 1999 Federal Law on Foreign Investments in the Russian Federation specifically allows the government to regulate foreign investment for the defense of the country or the security of the state. However, implementing regulations were never issued. According to Russian government officials, two transactions, one an acquisition by a U.S. company of Russian facilities that produced parts for the Russian military, revealed the need for a formal process to address national security concerns. The government has since drafted a new law to introduce a formal review of foreign investment, similar to reviews by CFIUS. The proposed law was submitted to the Russian Duma in July 2007; however a revised version was announced by the government in February 2008. According to the U.S. State Department, the revised law is more restrictive. As of February 26, 2008, the legislation had not been passed and is therefore subject to change. If the most recent version of the Strategic Sectors Law is enacted, foreign investors will need government authorization to acquire a controlling stake in a Russian company in any of 40 strategic sectors. The new version also restricts foreign investment to 10 percent in companies utilizing strategic subsoil assets, including oil, gas, gold, and copper. In addition, the Russian government is in the process of drafting amendments to the Russian Federation Law on Subsoil. (See app. XI for more information on the draft Strategic Sectors Law and draft amendments to the Subsoil Law.)

United Arab Emirates

The UAE does not have a process for reviewing foreign direct investment or a law that restricts foreign investment specifically for national security purposes. However, the UAE's regulatory and legal framework favors domestic over foreign investment. For example, the UAE's Companies Law and the Agencies Law limit foreign ownership to 49 percent and mandate that trade must be conducted through an Emirati agent. The UAE does not allow foreign majority ownership of any business outside of designated Free Trade Zones, and restricts foreign ownership of land. Although no UAE law restricts foreign investment specifically for national security, protection of the UAE's oil and natural gas deposits is effectively a national security issue. According to both U.S. and UAE officials, the UAE government plans to liberalize the Companies Law and the Agencies Law. However, this probably will happen in stages on a sector-by-sector basis.

The United Kingdom and the Netherlands

The United Kingdom and the Netherlands maintain the most open economies of all the countries we reviewed. However, changes to regulations affecting foreign investment have been discussed in these countries. For example, as a result of a potential foreign investment in the energy sector, the United Kingdom considered whether changes to its existing foreign investment laws or review process were required. The British government decided against making any changes to its current laws. Similarly, members of the Dutch Parliament have discussed the possibility of changes to their merger and acquisition regulations as a result of a recent transaction.

Foreign Investment Review Implementation Has Many Similarities in Different Countries

While there are many unique characteristics to the systems employed by the 10 countries to regulate foreign investment, in many ways the systems are similar to each other, and in several ways similar to the CFIUS process in the United States. See table 3 for a comparison of selected elements of the countries' foreign investment review processes.

Table 3: Common Elements

	Relevant FDI laws	Formal review	National security review	Reviewing body	Sectors requiring review	Reasons for review/restrictions	Review time frames	Appeal	Approval conditions or mitigation agreements
Canada	Investment Canada Act, 1985	Yes	No	Industry Canada and Canadian Heritage	Specified	To ensure net benefit to Canada	45 days, with a possible 30-day extension	No	Yes
China	2006 Regulations for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors Catalog for the Guidance of Foreign Investment Industries	Yes	Yes	Ministry of Commerce	Specified	National economic security, protection of critical industries, purchase of famous trademarks or traditional Chinese brands	Not specified	No	Yes
France	Law 2004-1343 Decree 2005-1739	Yes	Yes	Ministry of Economy, Finance, and Employment	Specified	Public order, public safety, national defense	60 days	Yes	Yes
Germany	2004 Amendment to 1961 Foreign Trade and Payments Act	Yes	Yes	Federal Ministry of Economics and Technology	Specified	Essential security interests, disturbance of peaceful international coexistence, disturbance of foreign relations	30 days	Yes	No
India	Foreign Exchange Management Act, 1999	Yes	Yes	Foreign Investment Promotion Board	Specified	National security, domestic, cultural and economic concerns	30 days, in practice 3 months	Yes	No
Japan	1991 Amendment to the Foreign Exchange and Foreign Trade Act of 1949	Yes	Yes	Ministry of Finance	Specified	National security, public order, public safety, or the economy	30 days, ministries can extend to 5 months	Yes	Yes
The Netherlands	Financial Supervision Act of 2006	No	No	N/A	N/A	Competition, financial market oversight	N/A	N/A	N/A
Russia	1999 Federal Law on Foreign Investments	Yes	Yes	Federal Anti-Monopoly Service	Not currently specified	Protection of foundations of the constitutional order, national defense and state security, anti-monopoly	30 days for anti-monopoly review (No specified time frames for national security review)	Yes	Yes
United Arab Emirates	Agencies Law of 1981 Companies Law of 1984	No	No	N/A	N/A	Economic and demographic concerns	N/A	N/A	N/A
United Kingdom	Enterprise Act of 2002	Yes	Yes	Office of Fair Trading	Not officially specified	Public interest, control of classified and sensitive technology	6 months, in practice 30 days	No	Yes
United States	Exon-Florio Amendment to the Defense Production Act of 1950, as amended	Yes	Yes	Committee on Foreign Investment in the United States	Not officially specified	National security	30 days, with a possible 45-day investigation	No	Yes

Source: GAO analysis of country data.

Note: N/A means “not applicable.”

Eight of the 10 countries use a formal review process to approve or deny a transaction. Generally, this review is conducted by a government economic body with input from government security bodies, and national security is a primary factor or one of several factors considered in evaluating transactions. Although the concepts of national security vary from country to country, all countries share similar concerns about national security-related issues. These concerns include, for example, their defense industrial base, and more recently, investments in energy sectors and investments of state-owned enterprises and sovereign wealth funds; the latter because of concerns that political rather than economic motivation may be behind the investment.

As in the United States, most countries have established time frames for the review ranging from 30 days to 6 months, and a majority of the governments can require that certain conditions be met prior to approving a transaction. For example, a country may place national citizenship requirements on company board members. Unlike the U.S. system, most countries' reviews are mandatory if the investment reaches certain dollar thresholds or if the buyer will obtain a controlling or blocking share in the acquired company. Finally, unlike in the U.S. process, five countries allow review process decisions to be challenged in court or through administrative means. In addition to the formal mechanisms, there are unofficial factors that may influence investment in each of the 10 countries. For example, in some countries, it may be necessary to vet sensitive transactions through a political process before the formal legal or administrative process is initiated.

Most Countries Use a Formal Review Process to Regulate Foreign Investment

Eight of the 10 countries we examined rely primarily on a review process through which the government grants or denies approval for transactions, usually above a specified threshold or within specified economic sectors. Canada reviews investments above specified monetary thresholds to determine if they would provide a net benefit to Canada. China maintains a decentralized review process split between central and local government authorities and retains the power to restrict or block any foreign investment that may have a significant impact on national economic security. In France, prior government authorization is required for foreign investments in 11 sensitive sectors. Germany reviews foreign investments specifically for national security purposes, but limits those reviews to investments in the German defense industry. Although foreign investment in India is primarily regulated through sector-based ownership restrictions, India also uses a review process. Japan reviews transactions in sectors potentially affecting national security, public order, public

safety, and the smooth management of the economy. Any foreign investment over 10 percent in a company listed on the Japanese stock exchange and any investment in an unlisted company that falls into the specified sectors must provide prior notification and is reviewed. Investment in all other sectors must provide notification after the investment is made, but those investments are not reviewed. In Russia the anti-monopoly review has been used to review foreign investment transactions for national security purposes. The government of the United Kingdom has the authority to review and block transactions that may have an adverse effect on competition and the public interest. The United Kingdom also can intervene when confidential defense-related information is involved. This latter intervention is separate from the formal competition review.

Besides a formal review process for foreign investment, every country reviewed had companies and sectors that are fully or partially government owned or controlled. For example, in India, foreign investment in the state-owned atomic energy is prohibited. In the Netherlands, as well as other countries, there are restrictions in areas such as transportation and public utilities. In the UAE and China, there are significant restrictions in a number of areas.

Some countries have companies that are fully or partially owned or controlled by the government that may allow domestic private investment, but restrict foreign investment. An example of this type of barrier to investment includes golden shares. Golden shares are special rights given to governments in private companies. Such rights allow the government to maintain a certain degree of control over such companies. For example, a government may maintain control over the percentage of foreign-owned shares, or approval requirements for the dissolution or disposal of any strategic assets. The European Court of Justice ruled against governments utilizing golden shares in 2002 and 2003 because these shares restrict the free movement of capital within the European Union (EU), and determined that the use of golden shares is acceptable only in specific circumstances.

Reviews are Normally Conducted by an Economic Body within the Government

All 8 of the countries with a review process have formally designated an economic-related ministry or body within the government to conduct the review. This body generally coordinates as needed with government security bodies. For example, similar to several countries we reviewed, France's Ministry of Economy, Finance, and Employment is the focal point of the review, and this ministry confers with the Ministry of Defense and

other relevant ministries, depending on the sector of the proposed investment. In China, the Ministry of Commerce has primary responsibility for reviewing and supervising foreign investment transactions. In Japan, foreign investors must provide notification to the Ministry of Finance and the ministry with industry area jurisdiction. Russia and the United Kingdom both maintain the legal process to block investments based on national security concerns. Investments that must be reviewed for national security reasons are routed through their competition review process. None of the countries we studied, however, maintain a formal interagency review committee such as CFIUS.

As is the case in the United States, in other countries, such as France, India, and Russia, bureaucratic tension exists between economic government bodies and generally more conservative, security-focused bodies within the government such as the defense ministry. This natural tension serves to balance economic and security concerns both when laws and policies are being developed and when decisions are made on individual applications in the review process.

Countries Share Similar Concerns about Foreign Investment

Many of the countries have concerns about national security-related issues. National security, as viewed by each of the countries, is a primary factor to be considered in evaluating transactions in seven of the eight countries with a review process. It is Germany's sole factor for review of investments. However, there is diversity among the countries as to what is considered essential to national interests and when it is necessary for the government to protect certain sectors from foreign investment or control. This diversity is reflected in each country's foreign investment regulatory regime. Factors considered during the review of foreign investment in other countries include public safety, public order, economic concerns, and cultural policies. Some countries do not specifically use the term "national security" in their laws, and most countries do not define what is covered under the term "national security," or similar terms such as "public interest," "public order," or "essential security."

Most countries have provisions that limit the sale of defense companies to foreign investors or provide for a review of those investments. The Chinese *Catalog for the Guidance of Foreign Investment Industries* states that foreigners are prohibited from investing in Chinese companies that manufacture weapons and ammunition. India requires official approval and limits foreign ownership in the defense industry to 26 percent. In the UAE, foreign investment in military production is clearly, if not explicitly, off limits, according to a UAE official. Japan requires prior

notification and approval for foreign investment in defense-related industries, including companies producing dual use items. France and Germany require reviews for foreign investment in companies with sensitive or classified technologies or contracts, while Russia and the United Kingdom also normally review these investments. The other two countries we reviewed are less restrictive. Canada's review process does not address foreign investment in the defense sector beyond the thresholds for review that apply to all foreign investments. The Netherlands has no restrictions on foreign investment in the defense industry other than those that are derived from international agreements.

All countries, with the exception of Germany, have specific restrictions or review requirements that apply to investments in companies involved in the production or distribution of energy. This issue of energy security, especially with regard to the foreign acquisition of energy infrastructure, has been raised by the European Union. For example, in September 2007, the European Commission put forth a proposal to establish a European energy policy. One aspect of this energy policy proposal would be a prohibition on non-EU companies acquiring control of a European Community energy transmission system or transmission system operator, unless it is specifically permitted by an agreement between the EU and the foreign company. The stated goal of this proposal is to promote competition, but the effect would also be to block foreign companies, state-owned enterprises, sovereign wealth funds, and others from being able to acquire certain energy assets in an EU country.

Some countries review or restrict foreign investment based on economic security or cultural nationalism. Canada, China, and Japan formally indicate economic reasons as part of the criteria for the review of foreign investment. For example, China reviews the acquisition of traditional Chinese brands, and Canada restricts foreign investment specifically to protect Canada's cultural heritage. The UAE also has in place investment restrictions focused on ensuring UAE citizen involvement in the country's economy. India maintains restrictions on investments in the financial sector, defense industry, real estate, infrastructure, telecommunications, print media, and single-brand product retail, among other sectors.

Government officials in six countries have expressed specific concerns about investments by foreign state-owned enterprises or sovereign wealth funds. Because sovereign wealth funds are government owned, there are concerns that they may be guided by political objectives rather than profit maximization or that their financial decisions may be motivated by support for certain "national champion" companies. A sovereign wealth

fund is a fund owned by a government and is composed of financial assets such as stocks, bonds, property, or other financial instruments. Sovereign wealth funds are generally composed of government fiscal surpluses, or from official foreign exchange reserves at central banks. Because of the unknown potential for sovereign wealth funds to be motivated by political instead of economic considerations, countries may seek to limit such investments.

On February 27, 2008, the European Commission released a document entitled *A Common European Approach to Sovereign Wealth Funds* proposing that EU leaders endorse a common EU approach to increasing the transparency, predictability, and accountability of sovereign wealth funds. The International Monetary Fund (IMF) is also developing best practices on how to manage sovereign wealth funds.¹⁸ According to the IMF, sovereign wealth funds have existed since the 1950s, but their total size worldwide has increased significantly in the last 10 to 15 years. The IMF estimates that as of September 2007, total holdings of sovereign wealth funds were between \$2 trillion and \$3 trillion, and may reach \$10 trillion by 2012.¹⁹

China, Russia, and the UAE all maintain sovereign wealth funds whose worth is estimated in the billions of dollars. Japan has also proposed establishing its own sovereign wealth fund, according to a private sector representative. In Germany and France, specific concerns have been raised about sovereign wealth funds investing in the two countries. In a joint letter, the German Chancellor and the French President wrote to the current President of the European Union Council in September 2007 to request that attention be paid by the European Union to the manner in which sovereign wealth funds can distort competition, as well as to call for a code of conduct to be developed for hedge funds investing in Europe. The letter emphasized that financial market transparency and appropriate regulation and supervision of investors is necessary to avoid potential negative results. Further, the German government is considering whether to develop measures to address concerns about the implications of sovereign wealth funds acquiring German companies.

¹⁸ The Organization for Economic Co-operation and Development has also issued guidance on the corporate governance of state-owned enterprises.

¹⁹ The IMF has encouraged exporters of nonrenewable resources to build up sovereign wealth funds in preparation for when the price of these resources fall, or when they are no longer able to rely on the export of such resources.

Russian government officials told us that under the July 2007 version of the proposed Strategic Sectors Law, state-owned enterprises and sovereign wealth funds would require government approval and will not be able to obtain a controlling share in certain strategic sectors. The U.S. State Department has indicated that in the February 2008 version of the draft, entities partially owned by a foreign government would face a 5 percent limit on unsupervised ownership. In December 2007, the Canadian government issued new guidelines to clarify how the Investment Canada Act applies to state-owned enterprises, including sovereign wealth funds. Entities within the United Kingdom and the Netherlands have also expressed concerns about foreign government-controlled investments, but the governments do not currently have plans to revise their foreign investment policies to address those concerns.

Most Countries Specify Review Time Frames, Can Set Conditions on Approval, Specify Thresholds for Review, and Allow Appeals

Every country except China specifies time frames in which the review is to be completed. Time frames tend to be between 30 and 60 days, and in some cases the review may be extended up to 6 months. In Germany, a transaction is automatically approved unless it is denied within 30 days of application. In Japan, the time frame for review is also 30 days, but can be extended up to 5 months. France's review is required to be completed within 2 months. In Canada, the review should be completed within 45 days, with the possibility of a 30-day extension. In India, approval should be given within 30 days. However, a government official stated that, in practice, the review usually takes 3 months. In Russia, the current anti-monopoly review time frame is 30 days, but national security reviews have no set time frames.²⁰ Reviews in the United Kingdom must be completed within 6 months, although many are completed in 30 days. In several countries, including Canada, France, and Germany, the review time frame does not start until the reviewing body considers the application package complete. As a result, the period from the initial application to the official approval can be longer than the stated review period.

The requirement of an investor to meet certain conditions prior to official approval of a transaction is common among six of the countries we reviewed. These conditions, also referred to as undertakings, contingencies, or mitigation agreements, were generally similar in each of the countries. For example, a country may place national citizenship

²⁰ Under the proposed Strategic Sectors Law, the review time frame is 90 days, with the possibility of a 90-day extension.

requirements on an acquired company's board members, or a company may be required to maintain its defense contracts after an acquisition. Examples of conditions imposed by the French government include (1) guaranteed continuation of the activities of the company, (2) protection of the companies' research and development capabilities, and (3) guarantees that the company will meet its obligations under its current procurement contracts. In the United Kingdom, when foreign investors have acquired companies that produced items for the military, those investors have been required to agree to conditions related to the maintenance of strategic capabilities. For example, when a U.S. defense company acquired a defense company in the United Kingdom, the British government required the acquiring company to agree to certain conditions related to the protection of classified technology and information. We also found that similar conditions have been required in Canada and Russia. Further, some countries have required annual reporting by the investing companies to ensure adherence to the mitigation agreements, and may require divestment if the company does not adhere to the agreements.

Of the eight countries with a review process, six maintain official thresholds for review, either dollar thresholds or a controlling or blocking stake, which may be defined differently in each country. China reviews all transactions at some government level. India requires government notification for all investments, and does not specify monetary thresholds for review. In Germany, an investor's failure to comply with the notification requirement may generate civil and criminal penalties. Countries generally rely on the fear of reprisal, fines, or mandatory divestment to encourage application and adherence to their review process, rather than actively pursuing companies that do not file.

Unlike the United States, five countries allow judicial appeal of decisions or have an administrative procedure to ask for reconsideration of a decision made as a result of the review process. However, the appeals processes are rarely used, primarily because the review processes rarely result in a formal denial.

Foreign Investment Is Affected by Factors outside Formal Processes

In practice, there are often informal or unofficial factors that may influence the success or failure of a potential foreign investment. Certain foreign investments may be considered sensitive by the host government; therefore, a firm may informally contact the host government to discuss the transaction prior to formal application for review. This was a common practice in several of the selected countries. Seeking unofficial preapproval can enable the potential investor to assuage any concerns the

host government may have about the pending transaction. Likewise, if a host government is unlikely to approve a transaction, this can be communicated to the investor prior to the formal application process. In such a case, the investor may never apply for review because of unofficial feedback from government officials concerning the likelihood of approval. In other circumstances, a firm may withdraw its application for a review if it receives unofficial feedback from the government that the transaction is unlikely to be approved.

Although the laws and policies that regulate the review of foreign investment are generally designed to be apolitical, for example, by basing the review mechanism in an administrative component of the host government, political influence in the public sphere may negatively affect the outcome of an attempted investment. Regardless of the official policy of the country, domestic politics play an important role in the review and approval of foreign investment. This can add a measure of uncertainty to the review process. According to the Organization for Economic Co-operation and Development (OECD), political pressure often occurs in areas of policy that are loosely defined, such as protecting national and cultural interests. Political figures may be able to block an investment on these grounds.

While most governments support foreign direct investment in their economy, in some instances the perceived economic impact of a particular investment may still be a cause for concern. According to the OECD, countries may attempt to mask this by citing national security considerations or other legitimate national interests to block a foreign investment transaction. The European Commission has reported to the OECD that these reasons have been cited in several instances by European Union member states to disguise economic or protectionist actions.²¹ In some cases, host governments may seek to protect certain companies, “national champions,” from external takeover or competition. National champions may be protected from foreign acquisition through, among other means, the public comments of political figures or the provision of

²¹ Article 21 (4) of the European Commission Merger Regulation provides the possibility for member states to take measures to protect their legitimate interests, other than defending against competition, if they are compatible with the general principles and other provisions of European Community law. Public security, plurality of the media, and prudential rules are generally acknowledged as legitimate interests. If national governments adopt incompatible measures, the European Commission is entitled to adopt a decision declaring them illegal and requiring their withdrawal.

government assistance to aid a company in seeking an alternative domestic merger partner.

The public may also react negatively to foreign investment. For example, the 2006 Chinese mergers and acquisitions regulations allow competing domestic firms to request that the Chinese government review a foreign merger or acquisition for anti-trust concerns, a procedure that provides Chinese companies a legal process to become involved in decisions about foreign investment reviews of their competitors. Further, the public may react negatively to the sale of local companies to foreign firms because such sales may place a local region's economy in the control of a foreign entity. Local employees and residents may fear that foreign investment will increase the likelihood of layoffs and other reductions in force. The practice of foreign private equity firms purchasing a company to obtain its assets, and then laying off or significantly restructuring the local workforce so as to reap rapid profits through resale of the company, is a concern, and has been referred to as "vulture" and "locust" capitalism in Japan and Germany.

Agency Comments and Our Evaluation

We requested and received written comments on a draft of this report from the Department of the Treasury. The comments are included in their entirety in appendix II of this report. In its letter, Treasury reemphasized the commitment of the United States to an open investment policy and stated that countries' general investment policies and the relationship of foreign investment reviews to those policies are important in understanding investment review regimes. Treasury coordinated with other CFIUS agencies in providing comments. Several agencies also provided technical comments, which we have incorporated as appropriate.

We are sending copies of this report to the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs and to the Chairman and Ranking Member of the House Committee on Financial Services. We will also send copies to the Secretaries of Commerce, Defense, Treasury, State, and the Office of the United States Trade Representative. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-4841 or calvaresibarra@gao.gov if you have any questions regarding this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Appendix XIV lists the major contributors to this report.

A handwritten signature in black ink that reads "Ann Calvaresi Barr". The signature is written in a cursive style with a large initial "A" and "B".

Ann M. Calvaresi-Barr, Director
Acquisition and Sourcing Management

Appendix I: Scope and Methodology

This report expands and updates a 1996 GAO report that compared the laws and processes governing foreign investment in Japan, France, Germany, and the United Kingdom.²²

To identify the relevant laws and policies for regulating foreign investment in foreign countries, we selected a nongeneralizable sample of 10 countries based on the following criteria: the size of the reciprocal investment relationship with the United States, a variety of investment controls, regional diversity, prior GAO work in the subject area, and congressional interest. We held in-country interviews in 5 of the countries and collected basic information from officials in Washington, D.C., on the remaining 5 countries.

We held in-country interviews with officials in

- Canada,
- China,
- France,
- Germany, and
- Russia.

We collected basic information from officials in Washington, D.C., on

- India,
- Japan,
- the Netherlands,
- the United Arab Emirates, and
- the United Kingdom.

The information on foreign laws and regulations in this report does not reflect our independent legal analysis, but is based on interviews and secondary sources such as analysis by the U.S. Library of Congress and our review of the laws in the original language, or translated copies of the various foreign laws obtained from foreign government officials, foreign government Web sites, or U.S. State Department sources. The U.S. Library of Congress compiled a summary of the laws and policies relevant to the regulation of foreign investment for each of the selected countries at our request. We also interviewed and obtained information from U.S. government officials from the Departments of the Treasury, Commerce,

²² GAO, *Foreign Investment: Foreign Laws and Policies Addressing National Security Concerns*. [GAO/NSIAD-96-61](#) (Washington, D.C.: Apr. 2, 1996).

State, and Defense; the Office of the U.S. Trade Representative; and the Intelligence Community Acquisition Risk Center under the office of the Director of National Intelligence. In addition to Washington, D.C., based sources, we interviewed U.S. embassy representatives in Canada, China, France, Germany, and Russia as well as the U.S. Mission to the European Union. We also obtained information from U.S. embassy officials in India, Japan, the Netherlands, the United Kingdom, and the United Arab Emirates.

We interviewed or obtained information from foreign government officials at each of the 10 embassies in Washington, D.C. For 5 of the countries—Canada, China, France, Germany, and Russia— we met with representatives in various foreign government offices and discussed how foreign investment is regulated.

We interviewed representatives from the European Commission in Belgium and the Organization for Economic Co-operation and Development (OECD) in France. We reviewed reports from the OECD, the United Nations Conference on Trade and Development (UNCTAD), the International Monetary Fund (IMF), and the Eurasia Group, among others, to obtain information about foreign investment review processes, laws, and policies, as well as basic figures for comparing foreign investment inflows.

To identify how countries implement foreign investment regulations, we interviewed a broad range of representatives for each of the selected countries, including think tanks and other nongovernmental organizations, business and trade associations, chambers of commerce, law firms, and industry representatives that have invested in the selected countries, all of whom possessed expert knowledge about foreign investment. In Canada, China, France, Germany, and Russia, we interviewed representatives for these organizations that were based in-country as well as in the United States, while for India, Japan, the Netherlands, the United Kingdom, and the United Arab Emirates, we only interviewed organizations, firms, and businesses that had offices in the United States.

While our observations provide a cross section of various types of foreign investment regimes, such observations are not representative of how all countries regulate foreign investment. Further, as reporting standards for foreign direct investment figures vary from country to country, we were unable to obtain comparable country- and sector-specific foreign direct investment-related data. We did obtain information and data available through UNCTAD, IMF, and OECD. Finally, it is impossible to know the

full extent to which informal factors influence investment, and specifically the process for reviewing foreign direct investment. Although there has been significant cross-border investment, it is unknown how many potential foreign investments were forgone or never pursued because of the burden imposed by the regulations that were in place in a given country. Official figures for denials and approvals were not available for some of the countries we reviewed, and the figures that are available do not necessarily represent the extent to which foreign investment restrictions or barriers affect investment. Likewise, data do not exist to determine the number of transactions initially pursued that were withdrawn prior to receiving government approval.

We conducted this performance audit from December 2006 to February 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 28, 2008

Ms. Ann Calvaresi-Barr
Director
Acquisition and Sourcing Management
U.S. Government Accountability Office
Washington, DC 20548

Dear Ms. Calvaresi-Barr:

Thank you for providing the Department of the Treasury with the opportunity to review and comment on the draft of Government Accountability Office (GAO) report GAO-08-320, "Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries." We believe that the report is a useful summary and analysis of the foreign investment restrictions of the countries covered by the report, and we appreciate the significant research that went into the report.

We offer the following comments that we believe would make the report even more useful to Congress, as well as to our international outreach efforts on these topics.

The Committee on Foreign Investment in the United States (CFIUS) conducts national security reviews of certain foreign investments in U.S. businesses within the context of the long-standing U.S. commitment to open investment. President Bush reiterated this commitment in his Statement on Open Economies in May 2007, as well as in the executive order he issued on January 23, 2008, instituting certain reforms to the CFIUS process to implement the Foreign Investment and National Security Act of 2007 (FINSA). The legislative history of FINSA also makes clear Congress's intention to maintain CFIUS' open investment orientation.

FINSA, the new executive order, and our internal reforms to the CFIUS process demonstrate that it is possible to safeguard the national security while continuing to welcome foreign investment. These reforms ensure that CFIUS is able to conduct robust reviews to address national security concerns in each of its cases. Consistent with the U.S. open investment policy, the reforms also ensure that CFIUS will focus only on genuine national security concerns, not on broader economic or policy goals, including industrial policy.

In his Statement on Open Economies, President Bush also stated that the United States is equally committed to securing fair, equitable, and nondiscriminatory treatment for U.S. investors abroad. Accordingly, Treasury is engaged with other countries, both bilaterally and multilaterally, to encourage them to ensure that any foreign investment review

processes they may have or be considering are designed and conducted consistent with open investment principles. We will be placing special emphasis on this point in the coming months, during and after the issuance process for revised CFIUS regulations to implement FINSA.

The general investment policies of the United States and the countries covered by the report, and the relationship of foreign investment reviews to those policies, are important to consider in order to understand and compare CFIUS and other countries' investment review regimes.

We hope you will find these comments helpful. Please feel free to contact me if you would like to discuss any of our comments or have any other questions.

Sincerely,



Nova Daly
Deputy Assistant Secretary
for Investment Security and Policy

Appendix III: Highlights of Recent Changes to Exon-Florio

On July 26, 2007, the President signed the Foreign Investment and National Security Act of 2007 (FINSAs) into law.²³ FINSAs amends section 721 of the Defense Production Act of 1950, also known as the Exon-Florio amendment.²⁴ The following provides a summary of some of the more significant changes to Exon-Florio, which became effective on October 24, 2007. FINSAs provides that implementing regulations shall become effective no later than April 21, 2008.

The Committee on Foreign Investment in the United States

Prior to FINSAs, Exon-Florio gave the President the authority to investigate the impact of foreign acquisitions of U.S. companies on national security, and by executive order the President delegated that authority to the interagency Committee on Foreign Investment in the United States (CFIUS).²⁵ FINSAs statutorily establishes CFIUS to carry out reviews and investigations as well as other responsibilities assigned to it in the act or delegated by the President. FINSAs also defines the membership of CFIUS, but allows the President to add the heads of other executive departments, agencies, or offices. Table 4 shows pre- and post-FINSAs membership of CFIUS.

²³ Pub. L. No. 110-49 (2007).

²⁴ 50 U.S.C. App. § 2170 (2006).

²⁵ Exec. Order No. 11,858, 3 C.F.R. 990 (1971-1975), as amended by Exec. Order No. 12,188, 3 C.F.R. 131 (1981); Exec. Order No. 12,661, 3 C.F.R. 618 (1989); Exec. Order No. 12,860, 3 C.F.R. 629 (1994); and Exec. Order No. 13,286, 3 C.F.R. 166 (2004).

Table 4: Changes in CFIUS Membership

Established by executive order prior to FINSA	Established by FINSA and Amendment of Executive Order 11858, issued January 23, 2008
Secretary of the Treasury (chair)	Secretary of the Treasury (chair)
Secretary of Commerce	Secretary of Commerce
Secretary of Defense	Secretary of Defense
Secretary of Homeland Security	Secretary of Homeland Security
Secretary of State	Secretary of State
Attorney General of the United States	Attorney General of the United States
Chairman of the Council of Economic Advisors	<i>Chairman of the Council of Economic Advisors</i>
Director of the Office of Management and Budget	<i>Director of the Office of Management and Budget</i>
Director of the Office of Science and Technology Policy	<i>Director of the Office of Science and Technology Policy</i>
The U.S. Trade Representative	<i>The U.S. Trade Representative</i>
Assistant to the President for Economic Policy (National Economic Council)	<i>Assistant to the President for Economic Policy (National Economic Council)</i>
Assistant to the President for National Security Affairs (National Security Council)	<i>Assistant to the President for National Security Affairs (National Security Council)</i>
	<i>Assistant to the President for Homeland Security and Counterterrorism</i>
	Secretary of Energy
	Secretary of Labor (nonvoting, ex officio)
	Director of National Intelligence (nonvoting, ex officio)
	The heads of any other executive department, agency, or office, as the President or the Secretary of the Treasury determines appropriate, on a case-by-case basis

Sources: Exec. Order No. 11858, as amended, and Pub. L. No. 110-49.

Note: New members added by FINSA are in bold. Members added by the Amendment to the Executive Order are in italics.

Critical Infrastructure

Although transactions involving U.S. critical infrastructure were reviewed and investigated by CFIUS in the past, Exon-Florio did not explicitly provide for reviews or investigations of critical infrastructure. FINSA specifically identifies critical infrastructure as an area of concern. For

example, FINSA explicitly requires CFIUS to investigate transactions that involve critical infrastructure if the transaction could impair the national security of the United States and the impairment has not been mitigated.²⁶ Also, FINSA specifically identifies the effect of a transaction on United States critical infrastructure as a factor that must be considered by CFIUS in conducting a national security review.

Investigations

Prior to FINSA, Exon-Florio provided for a 45-day investigation to determine the effects of a transaction on the national security of the United States, and for a mandatory investigation in those cases in which the acquiring company is controlled by or acting on behalf of a foreign government and the transaction could affect the national security of the United States. FINSA specifically provides for a 45-day investigation when

- the lead agency responsible for negotiating mitigation agreements and other conditions and for monitoring compliance with mitigation agreements recommends an investigation and CFIUS agrees, or
- whenever a review results in a determination that
 - the transaction threatens national security and the threat has not been mitigated;
 - the transaction is a foreign government-controlled transaction; or
 - the transaction would result in control of critical infrastructure, CFIUS determines that the transaction could impair national security, and the impairment has not been mitigated.

However, FINSA also provides that an investigation is not required for foreign government-controlled transactions or transactions involving critical infrastructure if the Secretary of the Treasury and the lead agency jointly determine that the transaction will not impair the national security of the United States.

Factors to Be Considered

FINSA has expanded the number of factors for CFIUS and the President to consider in conducting reviews and investigations and making determinations of whether a transaction poses a threat to national

²⁶ In section 721 (b)(2)(D) FINSA also provides that an investigation is not required for transactions involving critical infrastructure if the Secretary of the Treasury and the lead agency jointly determine that the transaction will not impair the national security of the United States.

security. Under FINSA, CFIUS and the President must consider, as appropriate, the following additional factors:²⁷

- the potential national security-related effects on U. S. critical infrastructure, including major energy assets;
- the potential national security-related effects on U.S. critical technologies;
- whether the transaction is a foreign government-controlled transaction;
- as appropriate, and particularly with respect to transactions requiring an investigation, a review of the current assessment of
 - the acquiring country's adherence to nonproliferation regimes;
 - the relationship of the acquiring country with the United States, specifically on its record on cooperating in counterterrorism efforts; and
 - the potential for transshipment or diversion of technologies with military applications, including an analysis of national export control laws and regulations;
- the long-term projection of U.S. requirements for sources of energy and other critical resources and material; and
- the potential effects of the transaction on sales of military goods, equipment, or technology to any country identified by the Secretary of Defense as posing a potential regional military threat to the interests of the United States.

Mitigation Agreements

Prior to FINSA, neither Exon-Florio nor its implementing regulations addressed the issue of mitigation agreements—agreements between CFIUS or a member agency and the parties to the acquisition that are intended to mitigate national security concerns. FINSA explicitly permits CFIUS or a lead agency, as designated by the Treasury Department, to negotiate, enter into, impose, and enforce any agreement or condition with any party to the transaction to mitigate any threat to U.S. national security that arises as a

²⁷ The original factors include (1) domestic production needed for projected national defense requirements; (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services; (3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security; (4) the potential effects of the transaction on sales of military goods, equipment, or technology to any country identified under applicable law as (a) supporting terrorism or (b) a country of concern for missile proliferation or the proliferation of chemical and biological weapons; and (5) the potential effects of the transaction on U.S. international technological leadership in areas affecting national security. 51 U.S.C. App. § 2170(f) (2006).

result of the transaction. FINSA also provides that a lead agency shall monitor and enforce, on behalf of CFIUS, any mitigation agreement.

Tracking Withdrawn Notices

Prior to FINSA, Exon-Florio contained no provisions for actions to be taken in the event companies withdrew an official notification to CFIUS, although the implementing regulations provided procedures to companies on how to request a withdrawal. FINSA specifically provides for CFIUS to establish, as appropriate

- interim protections to address concerns raised during the review or investigation,
- time frames for the companies to resubmit notification to CFIUS, and
- a process for tracking any actions the companies may take before the companies resubmit the notification.

Reporting to Congress

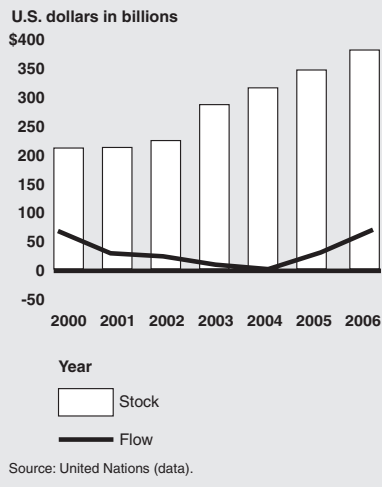
FINSA has expanded Exon-Florio's requirement for reports to Congress. Prior to FINSA, Exon-Florio required the President to submit a report to Congress only when the President made a determination whether or not to take action to block or suspend an acquisition using the authority of Exon-Florio. The report was required to address only the acquisition that was the subject of the presidential determination. FINSA requires annual reporting to specific congressional committees on all reviews and investigations completed by CFIUS during the preceding 12-month period, as well as a certified report on the results of any investigation shortly after CFIUS concludes the investigation, unless the transaction under investigation is sent to the President for a decision.²⁸ FINSA also provides

²⁸ We reported in September 2005 that, in some instances, the parties to a transaction withdrew their notification to CFIUS during the 45-day investigation and refiled notifications, thus avoiding a presidential decision and the resultant report to Congress. See GAO, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, [GAO-05-686](#) (Washington, D.C.: Sept. 28, 2005), 17.

for CFIUS to provide briefings to specific Members of Congress on any transaction that has been concluded.

Appendix IV: Canada

Foreign investment in Canada
(stocks and flows 2000–2006)



- Canada ranked sixth in terms of the average value of foreign direct investment (FDI) inflows worldwide between 2000 and 2006.
- In 2006, FDI in Canada totaled \$385.2 billion, an increase of 81 percent over FDI stock in 2000.
- FDI stock in Canada as a proportion of gross domestic product (GDP) was 30.4 percent in 2006.
- Canada was the second most popular destination for U.S. FDI, behind the United Kingdom as of 2006.

Background

Canada became a self-governing dominion in 1867 while retaining ties to the British crown. Canada is a constitutional monarchy with a federal system, a parliamentary government, and democratic traditions. Criminal law, based largely on British law, is uniform throughout the nation and is under federal jurisdiction. Civil law is also based on the English common law, except in Quebec, which has retained its own civil code patterned after that of France. Justice is administered by federal, provincial, and municipal courts.

For decades, foreign investment has been significant to Canada's market economy. The United States, the United Kingdom, France, and the Netherlands are Canada's largest foreign investors. At the end of 2006, the stock of U.S. investment in Canada was \$241 billion, about 61 percent of total foreign investment in Canada. Economic sectors with a relatively high foreign presence include manufacturing, oil and gas, wholesale trade, transportation and warehousing, and finance and insurance. Recently, merger and acquisition activity has been the largest part of foreign investment flows into Canada, accounting for 71 percent of inward foreign investment in 2005 and 2006, according to the Canadian government.

Canada is signatory to the World Trade Organization (WTO) Agreement and the North American Free Trade Agreement (NAFTA). Under WTO and NAFTA, Canada is generally required to provide national treatment and most favored nation status so that foreign investors are treated no less

favorably than domestic investors with respect to the establishment, acquisition, management, and sale of investments.

Foreign Investment Laws and Policies

The Canadian government, through the Investment Canada Act (ICA), provides for a foreign investment review process in order to ensure that the investment is likely to be of “net benefit” to Canada.²⁹ Under the ICA, Canada’s investment review process is managed by Industry Canada and led by the Minister of Industry. According to a Canadian government official, in the late 1990s, the review of cultural investments was shifted to Canadian Heritage under the direction of the Minister of Canadian Heritage. Ministry officials review all cases and identify other government ministries that need to be involved. For example, Industry Canada would consult with Natural Resources Canada for an acquisition dealing with oil or gas. All non-Canadians must file a notification with either Industry Canada or Canadian Heritage when they begin a new business in Canada or acquire an existing Canadian business. However, only transactions whose asset value reaches certain thresholds require a review.³⁰ The relevant Minister of either Industry Canada or Canadian Heritage makes the final decision on transactions.

Sensitive Sectors and Criteria for Review

National security is not currently a part of Canada’s foreign investment review process. Instead, the review considers a series of economic factors, as well as national cultural policy objectives. While Canadian officials told us that the ICA is not driven by national security, a number of laws, regulations, and policies allow Canada to deal with national security concerns stemming from foreign investments in certain sectors. Canada requires government review and approval in uranium production, financial services, transportation services (including pipelines), and cultural businesses.³¹ However, there is no specific exemption for the petroleum industry in the act. The financial sector is subject to ownership

²⁹Investment Canada Act, June, 20, 1985.

³⁰ The 2008 threshold for any direct acquisition of a Canadian business by an investor from a WTO country is Can\$295 million. For investments from non-WTO member countries and investments in certain sectors (cultural businesses, transportation, financial services, or the production of uranium) the threshold is Can\$5 million for direct investments and Can\$50 million for indirect transactions. Except for transaction exempted from the act, all transactions above these designated dollar thresholds are required to be reviewed.

³¹ Transactions in these sectors have a Can\$5 million threshold for review.

restrictions, and foreigners are limited to 25 percent ownership of air carriers, and 33 percent ownership in telecommunications companies. The Department of Canadian Heritage reviews investments in businesses that affect Canada's cultural heritage, including the publication of books, magazines, and newspapers as well as film and music production.

The factors assessed in the ICA review are (1) the effect of the investment on the level and nature of economic activity in Canada, including employment, resource processing, domestic sourcing, and exports; (2) the degree and significance of Canadian participation in the business enterprise and in the industry sector to which the enterprise belong; (3) the effect on productivity, industrial efficiency, technological development, innovation, and product variety in Canada; (4) the effect on competition in Canada; (5) the impact of the investment on Canada's ability to compete in world markets; and (6) the compatibility of the investment with national industrial, economic, and cultural policies, taking into consideration industrial, economic, and cultural policy objectives of any province likely to be significantly affected by the investment.

New Developments

On June 20, 2005, the Canadian government introduced a bill to amend its foreign investment review process. According to U.S. and Canadian government officials, the proposed bill included provisions to allow the government to review foreign investment based on national security concerns.³² The proposed law did not define national security and would have required the responsible minister to recommend a review, according to Canadian government officials. In addition, a transaction would have been reviewed only if it came to the attention of the intelligence or defense communities and they determined that it needed to be reviewed.

According to U.S. government officials, this bill was partially driven by concerns about recent attempts by Chinese firms to acquire Canadian natural resource assets. However, the Canadian Parliament was dissolved at the end of 2005 prior to the 2006 election, and the bill was never passed.

In 2006, the Department of Finance Canada issued *Advantage Canada*, an economic planning document stating that the Canadian government would review its foreign investment policy framework, including the Investment Canada Act, with the goal of maximizing the benefits of foreign investment for Canadians while retaining its ability to protect national interests. The

³²Bill C-59, an Act to Amend the Investment Canada Act, First Reading, June 20, 2005.

Canadian government has stated that there may be rare occasions where a particular foreign investment might damage Canada's long-term interests. For example, foreign investment by state-owned enterprises with noncommercial objectives and unclear corporate governance may not be beneficial to Canadians. Further, the Minister of Industry stated in October 2007 that the Canadian government's concern is to ensure that state-owned enterprises in Canada are operating under the same standards as any other commercial enterprise in Canada, including those related to transparency, good governance, and free market principles. In December 2007, the Canadian government issued new guidelines to clarify how the Investment Canada Act applies to state-owned enterprises, including sovereign wealth funds.

In July 2007, a Competition Policy Review Panel was created by the Canadian government to review key elements of Canada's competition and investment policies. The panel is to consider whether or not the government should develop new rules to protect Canada's national interests. The panel is expected to report to the Minister of Industry by June 30, 2008 with recommendations. The government of Canada is also separately examining the need for a mechanism to screen foreign investment on the basis of national security. According to a paper issued in October 2007 by the Competition Policy Review Panel, while Canadians have always been concerned about foreign influence on the Canadian economy, this concern has been exacerbated by a recent series of significant takeovers of a number of prominent Canadian firms by foreign investors, including mining companies like Falconbridge and Inco.³³

Review Process

The ICA review process begins when a company submits an application. The application must be filed at any time prior to the implementation of the investment. The application requires information about the investor, the investment, the Canadian business to be acquired, its assets, and the investor's plan for the Canadian business. In the application, companies also can take the opportunity to give their reasons why the minister should approve the transaction, according to Canadian government officials and private industry representatives. The ICA includes confidentiality provisions to protect the privileged information provided by the businesses through the course of the application process. Once the application is found to be complete, the Canadian government has 45 days

³³ Government of Canada, *Sharpening Canada's Competitive Edge*. Ottawa, Oct. 30, 2007.

to determine whether or not to approve a particular transaction. If the government does not send a notice to the applicant within 45 days, the application is considered approved. The Ministers of Industry and Heritage each have the option of extending the review by 30 days. Further extensions are permitted by agreement between the investor and the minister. According to the Canadian government, over the period from 2003 to 2007, the average length of an Industry Canada review was 52 days. The average Canadian Heritage review will usually take at least 75 days to complete.

The review includes the following steps:

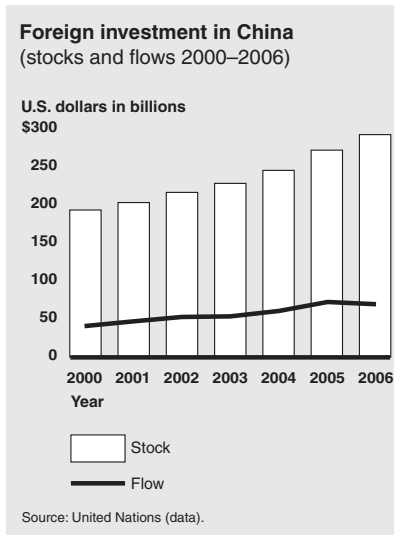
1. Government officials verify the application is complete.
2. Case officers share certain information with relevant government offices, both federal and provincial, and with the Competition Bureau.
3. Industry Canada and/or Canadian Heritage discuss the results of the review with the investor.

Conditions for Approval

To be granted approval for a transaction, investors must demonstrate that their investment will likely be of net benefit to Canada through their business plans and the conditions for approval, also called undertakings, which they negotiate with the Canadian government. The conditions for approval generally focus on future plans for the business following the completion of the transaction. According to the Canadian government, there has been a shift over time toward conditions related to productivity, technology transfer, and efficiency, and away from a focus on employment. Common conditions for approval might include the following:

- Canadian participation on the acquired company's board, usually 25 percent;
- Canadian participation in the acquired company's management;
- research and development expenditures;
- employment levels;
- productivity improvements; and
- exploration expenditures for transactions involving mining.

Appendix V: China



- China is the third largest recipient of FDI in the world, ranking behind the United States and the United Kingdom in terms of the average value of FDI inflows between 2000 and 2006.
- In 2006, FDI in China totaled \$292.6 billion, an increase of 51 percent since 2000.
- FDI stock in China as a proportion of GDP was 11.1 percent in 2006.

Background

Over the last several decades, China's economy has moved from a centrally planned system that was largely closed to international trade to a more market-oriented system. Since 1978 China's GDP has increased more than 1,000 percent. According to U.S. State Department officials, the development of Chinese investment regulations has not kept pace with the development of its markets, and the complexity of the foreign investment review process reflects vestiges of China's past as a planned economy. Since the period of economic reform began, China has continued to review inward investment to ensure proposed projects conform to China's industrial policy and national interests. Foreign investment in China typically began in the form of equity joint ventures in the manufacturing sector and, according to industry officials, has progressed to the point where foreigners can merge with or acquire entire Chinese companies.

Several Chinese government entities are involved in the review of foreign investment, including the following:

- *State Council*: The State Council is China's chief executive and administrative authority. Members include the Premier, as the head of government; a variable number of vice premiers; 22 ministers; and 4 State Council commission directors.
- *National Development and Reform Commission (NDRC)*: The NDRC is the State Council's economic policy planning arm. According to U.S. and industry officials, it is a powerful macroeconomic management agency with broad planning control over the Chinese economy, and specific control over heavy industry. U.S. and industry officials have

stated that the NDRC is deeply involved in the review of foreign investment transactions.

- *Ministry of Commerce (MOFCOM)*: MOFCOM is under the State Council and is charged with managing China's external economic relations. Its duties include formulating trade policy, regulating foreign participation in markets, implementing import and export quotas, implementing trade and economic cooperation policies, and guiding foreign investment.
- *State-owned Assets Supervision and Administration Commission (SASAC)*: SASAC is a commission under the State Council that represents the central government's ownership interests in 159 state-owned enterprises (SOE). As part of its duties, SASAC guides SOE reform, drafts laws and regulations on SOE management, and supervises the preservation of SOE value.
- *State Administration for Industry and Commerce (SAIC)*: SAIC is a State Council ministry in charge of supervising market competition, investigating illegal trade, regulating contract performance, and handling trademark registration and administration.

Foreign Investment Laws and Policies

According to Chinese officials, China's system of written law can be broken into different categories according to their level. Chinese laws that are broad and general form the highest level. They are passed by the Chinese legislative body, the National People's Congress, during its annual meeting in Beijing. At the next level are regulations that are issued by individual state ministries and are intended to interpret and characterize laws. Below that are guiding opinions. According to Chinese officials, opinions are not binding and are used as planning documents. However, according to one U.S. official, they are assumed to carry the weight of law. According to Chinese officials, since Chinese laws are broad and general, regulations and guiding opinions provide the real substance of the Chinese legal system.

In 2006, China began to adopt laws and regulations to describe the procedures it uses to review, and potentially block, proposed foreign acquisitions that it deems are not in China's national interest. According to Chinese officials, two regulations provide the primary framework for China's foreign investment review. First, the 2006 Provisions for Merger and Acquisition of Domestic Enterprises by Foreign Investors (the 2006 regulations)³⁴ are the most important rules for managing foreign

³⁴ These regulations update a version promulgated in 2003.

investment. According to the Organization for Economic Co-operation and Development, these regulations bring China closer to international norms for foreign investment reviews and increase regulatory transparency.

The 2006 regulations establish the need for government approval of foreign investment if the transaction

- affects national economic security,
- involves a major industry, or
- results in the transfer of famous trademarks or traditional Chinese brands.

If foreign investors fail to apply for approval, the Chinese government has the legal authority to force divestiture if a transaction causes or may cause significant impact on China's economic security.

Second, the Chinese *Catalog for the Guidance of Foreign Investment Industries* (the Catalog) restricts foreign investment in specified sectors. A revised version of the Catalog was issued by the NDRC in November 2007. According to Chinese officials, the Catalog is a reflection of industrial policy and is intended as a guide for foreign investors. It assigns industry sectors to one of three categories: "encouraged," "restricted," and "prohibited." Investment in unlisted sectors is automatically considered "permitted."

According to the U.S. Investment Climate Statement on China, the Catalog prohibits foreign investment in sectors that China views as key to its national security. However, the Catalog does not prohibit investment for stated reasons, or define national security, although some industries clearly fall into that category, including weapons and ammunition manufacturing, mining and processing of radioactive materials and rare earth metals, and construction and operation of power networks. Other sectors are prohibited based on a broader definition of national security, including film, television, book publishing, and other media production. Other prohibited sectors appear completely unrelated to national security, including processing special Chinese teas, preparation of traditional Chinese medicines, and production of enamel products and rice paper. According to U.S. and Chinese government officials, foreign investment in certain sectors may be encouraged if the investment would bring advanced technology into China that would benefit China's future economic development. Further, according to a U.S. State Department official, industry representatives have stated that China intends to restrict or ban

foreign investment in sectors deemed strategic or sensitive to economic security.

Additional Foreign Investment Laws and Policies

Other Chinese laws, regulations, and opinions also regulate foreign investment. However, only the Anti-Monopoly Law does so explicitly for national security.

- The State Council’s Opinions on Revitalizing the Industrial Machinery Industry: Suggests that “large, key and backbone equipment manufacturers” obtain government approval when transferring a “controlling stake” to foreign investors. It also calls for China to expand the market share of domestic companies in 16 equipment-manufacturing fields.
- The Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises: Lists seven sectors the government deems critical to the national economy, which must be kept under government control, including defense, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation, and shipping.
- The Anti-Monopoly Law: Adopted in August 2007, and becomes effective in August 2008. The law creates an antitrust review of foreign and domestic mergers and acquisitions and also orders the government to create a process to review inward investment for national security concerns. As of January 2008, implementing regulations for the law had not been released.
- Three overarching laws guide foreign investment: The Equity Joint Ventures Law, the Foreign Contractor Joint Ventures Law, and the Foreign Capital Enterprises Law. However, since Chinese laws are very general, the implementing regulations associated with each of these laws are more important for understanding foreign investment controls.
- According to Chinese officials, China has other industry- and sector-specific laws to control foreign investment; for example, in telecommunications or financial services. In total, China has more than 200 laws and regulations that involve foreign investment.

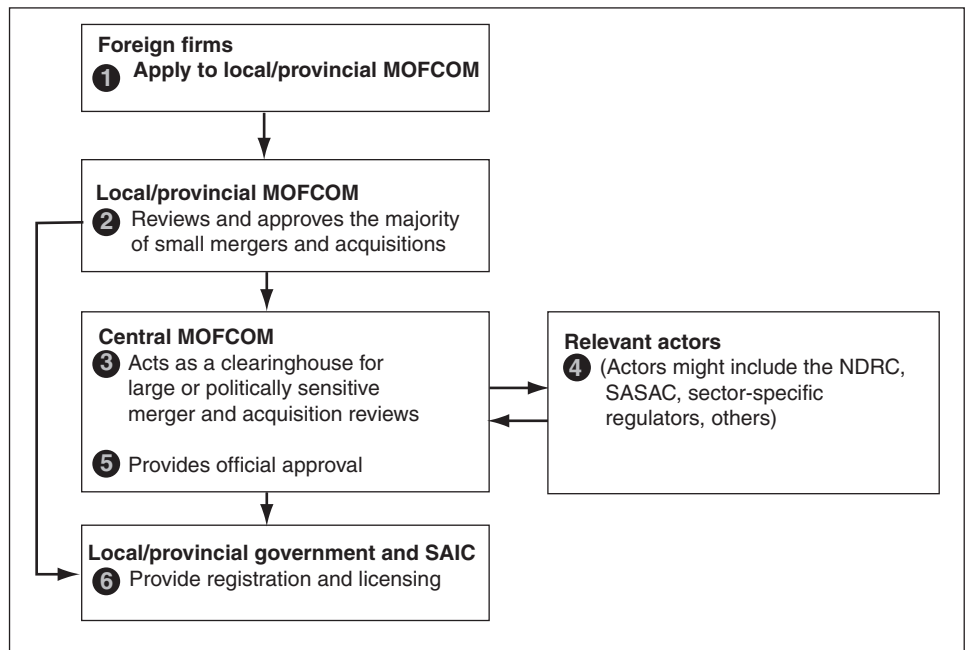
Review Process

China has a nominal process for reviewing all foreign mergers and acquisitions. The standards that China uses to conduct reviews of foreign investment are opaque, and have resulted in a system that is not fully transparent. However, it is clear that in addition to national security concerns, they also include an assessment of whether a given investment conforms to China’s economic development plan. Various factors make

China’s foreign investment review process unpredictable in practice. Factors affecting the review process include (1) competitor firms generating negative public attention that may influence relevant officials, (2) bureaucratic infighting, (3) differences in priorities between the local and central level Chinese government related to their motivations for the approval of foreign investment, (4) the Chinese political calendar, and (5) regulatory ambiguity and lack of procedural transparency. All five factors can affect the outcome of a particular review, resulting in an application process that is unpredictable for investors. In addition, China’s foreign investment regulations are considered complex, in transition, and lack definitions for key terms, making the review process ambiguous.

According to Chinese officials, there is one review process with many facets, and all transactions must go through the Ministry of Commerce.

Figure 2: Nominal Foreign Investment Review Process



Source: GAO analysis of information from Chinese Government officials.

Note: Steps 3 and 4 may occur simultaneously; Step 4 is sometimes omitted.

Step 1: All foreign investors must apply to the local or provincial-level Ministry of Commerce when attempting to merge with or acquire a Chinese firm.

Step 2: Most small transactions are reviewed and approved by the local-level Ministry of Commerce and then go to the local- or provincial-level government for registration and licensing. (Step 6.) If the local MOFCOM does not submit the review to the national-level MOFCOM, then it will distribute the application to the local subsidiaries of NDRC and SASAC, etc. These local subsidiaries may then forward the review to their national-level representatives if they find something of concern. (Step 4.)

Step 3: The central-level Ministry of Commerce reviews large or politically sensitive transactions. Factors affecting political sensitivity might include the size of the transaction, whether a state-owned enterprise is involved, whether the sector itself is sensitive, and whether actors involved in the transaction are connected to the State Council. At this point, the central-level Ministry of Commerce acts as the administrative coordinator for the review.

Step 4: Other relevant actors provide “preapproval.” This step generally determines whether or not a transaction will be approved. The NDRC plays an important role in the review as the lead economic planning agency, as does SASAC in cases involving Chinese state-owned enterprises.

Step 5: The central-level Ministry of Commerce reviews the application and provides the official approval or denial. If another governmental entity has jurisdiction, the Ministry of Commerce will rely on it to determine approval or denial. Within 6 months of a transaction being approved, the Ministry of Commerce issues a certificate of foreign investment.

Step 6: Once the central-level Ministry of Commerce issues a certificate of foreign investment, the foreign company has 1 month to obtain a business license and register the business with the State Administration of Industry and Commerce.

China’s foreign investment review process is unpredictable. While the great majority of transactions are cleared without incident, the review’s multiple layers and ambiguous standards allow intervention by parties opposed to a transaction, according to U.S. State Department officials. For example, the 2006 regulations state that domestic competitors of the Chinese firm being acquired can request that the Chinese government review a transaction for anti-trust concerns. According to U.S. and industry officials, domestic competitors can also indirectly affect transactions by generating negative public attention around a deal that could then affect decision makers. For example, when a U.S. private equity

firm attempted to purchase 85 percent ownership of a construction machinery company, the chief executive officer of a rival Chinese firm stated that selling the company to a foreign firm was not in China's interest, and he reportedly worked to derail the transaction. Recently this type of interference has become more common.

A second factor that can slow approvals is bureaucratic infighting. According to U.S. and industry officials, a number of Chinese bureaucracies have overlapping jurisdictions and competing interests, which can affect the outcome of a particular review. For example, Chinese officials in the Ministry of Commerce and the State Administration of Industry and Commerce both suggested they conducted anti-trust reviews, but, according to U.S. State Department officials, there appears to be little coordination of their efforts. This overlapping claim is indicative of the lack of clarity regarding what governmental bodies are involved in a given review.

A third factor that can affect approvals is the difference in incentives between the local and central level Chinese government when approving foreign mergers and acquisitions. According to U.S. government officials, there is a split between the central government, which is concerned about implementing social policies, and the local governments, which are more concerned with economic growth, providing jobs, and attracting investment. Since local governments have a large degree of influence in the approval process, they are one of the major forces counteracting protectionist tendencies in China.

A fourth factor is the Chinese political calendar. According to U.S. and industry officials, foreign firms can have increased difficulty getting government approval for mergers and acquisitions in the year preceding a Chinese Communist Party congress. The Chinese Communist Party convenes a party congress approximately every 5 years. At these events, the party decides its future policy positions and selects new leadership. According to U.S. and industry officials, the atmosphere preceding a party congress is politically charged. Since the appearance of appeasing foreigners can have negative political repercussions in the Chinese political system, many Chinese officials are apprehensive about approving any foreign investments during this time. In particular, since most top executives at state-owned enterprises are party members, investments that affect powerful vested interests, particularly in state-dominated sectors, or those that risk being viewed as contrary to central government policies, are more likely to face political interference according to the U.S. State Department.

In addition to those factors, according to U.S. officials and industry representatives, the relationships among various laws and regulations are complex and unclear. This lack of clarity lessens the ability of foreign firms to predict the likelihood of government approval of an investment. For example, Chinese officials stated that the 2006 regulations and the Catalog provide the primary regulatory framework for reviewing and regulating foreign investment. However, they could not articulate the relationship between the two other than to say that the Catalog is one of many factors considered in the review process. Moreover, according to a U.S. government official, Chinese laws tend to be vaguely worded and general in nature. This allows implementing ministries leeway in interpreting these measures. Implementing rules sometimes offer clarification. Further, according to the Organization for Economic Co-operation and Development, the 2006 regulations appear to create a new layer of review, in addition to the examination and approval process based on the Catalog.

In another example, the State Council Opinion on Revitalizing the Industrial Machinery Industry calls for China to expand the domestic market share in 16 equipment-manufacturing fields. The Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises lists seven sectors the government deems critical to the national economy, which must be kept in the state's hands. However, it is unclear how these opinions are related to the review process. A Chinese official from the commission that promulgated the list stated that it would be more difficult for a foreign firm to purchase a Chinese company in one of those sectors. However, another Chinese official did not view the list as important because it is nonbinding.

The Chinese government has not defined key terms in the 2006 regulations, contributing to a lack of transparency in the review process. The updated regulations add a screening requirement if the foreign investment transaction affects "national economic security," involves a "major industry," or results in the transfer of "famous trademarks" or "traditional Chinese brands. However, the regulations do not define these terms, making it difficult for businesses to determine when screening is required and when it is not.

According to U.S. government and industry officials, the definition of "national economic security" is particularly unclear. In fact, according to an industry official, the Ministry of Commerce has not publicly used national economic security as a reason for preventing a foreign merger or acquisition. According to the U.S. State Department, some Chinese

scholars affiliated with more protectionist factions of the government use national economic security to refer to self-sufficient economic growth. Thus, investment that would lead China to become dependent on foreign participation in the economy to sustain economic growth should be restricted. Other Chinese scholars believe national economic security refers to economic development that promotes stability, such as a continued increase in living standards, progress on environmental protection, and the creation of jobs. Since China's leaders see economic development as key to maintaining internal stability, national security and national economic security are treated as equally important, according to Chinese and U.S. officials. In practice, the sectors China considers important to national security are listed as forbidden in the Catalog.

Confusion over new regulations is common. According to industry representatives, the Chinese government sometimes promulgates a regulation that many, including those in the government charged with implementing the regulations, do not understand. Implementing regulations are key to spelling out the details of a law, but may be released after the law takes effect. When this occurs, the business community attempts to determine the parameters of the law or regulation through trial and error. Over time, the regulation will take shape. Accordingly, a U.S. State Department official said the lack of definitions and transparency in the 2006 regulations could be indicative of disagreements within the Chinese government regarding how to regulate foreign investment. Conversely, other U.S. and industry officials stated that the updated regulations are intended to allow the government discretion to restrict foreign investment when it is in its interest to do so.

Recent Developments

According to U.S. and industry officials, several factors may have contributed to a slowdown in foreign investment approvals and activity starting in mid-2006. These factors include pragmatic concerns by the Chinese government about the appropriate level of foreign investment and protectionist concerns commonly characterized as economic nationalism. As the Chinese government has promulgated new regulations, industry uncertainty has grown regarding China's review process. However, according to U.S. officials, it is impossible to know whether the current slowdown in approvals will continue or if it is merely associated with temporary political conditions. Nevertheless, according to U.S. and industry officials, the long-term trend toward improved regulatory transparency and efficiency remains positive.

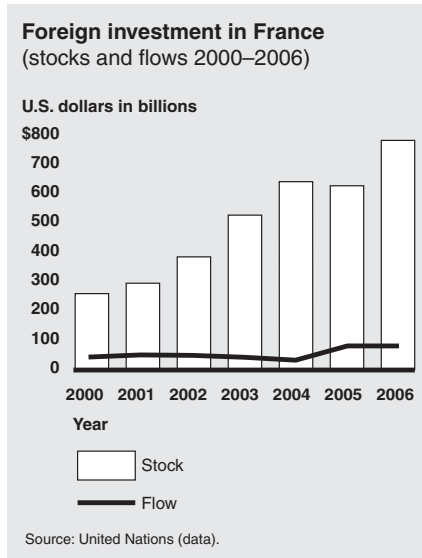
Factors cited as affecting the review process and foreign investment activity include the following:

- *Rapid rise in foreign investment:* Foreign mergers and acquisitions increased from 4 percent of foreign investment in 2002 to over 11 percent in 2005. According to U.S. and industry officials, some Chinese government officials are concerned about increased foreign control over China's economy.
- *Historical antecedents:* Large-scale foreign ownership of Chinese companies can appear to the Chinese as foreign encroachment, drawing on historical fears of foreigners taking control of their country.
- *Populist perceptions of foreign investment:* According to U.S. and industry officials, many people in China believe their country has sold vital state-owned enterprises and traditional Chinese brands to foreigners at below-market value. They fear China will lose its best companies to foreigners. In addition, they perceive that many foreign countries would not sell similar assets to Chinese companies.
- *High-profile transactions:* The U.S. State Department has reported that senior Chinese officials frequently point to the failure of China National Offshore Oil Corporation's (CNOOC) attempt to purchase the U.S. oil company Unocal as justification for China's new investment screening mechanisms. Later, a U.S.-based company's attempted purchase of a Chinese machinery company led to a public outcry against foreign acquisitions in China.
- *Competitor's interventions:* Chinese businesses are becoming more adept in using domestic media to generate opposition to inward investment that threatens their businesses.
- *Desire to build world-class companies:* According to Chinese and U.S. officials, the Chinese government wants to develop world-class companies that can compete internationally. This includes developing famous Chinese brands so that Chinese firms can retain a larger share of the profits from products they manufacture. The government would likely oppose foreign takeovers of these companies.
- *New regulations:* In June 2006 the State Council released an opinion defining machinery and capital equipment as pillar industries, and stating that selling key enterprises to foreigners will require its approval. In December 2006 SASAC released its list of seven sectors the government deems critical to the national economy. In August 2007 the National People's Congress promulgated the Anti-Monopoly Law, adding a national security examination to China's review process.
- *Change in industrial policy:* In November 2006 the Chinese government released its 11th 5-year plan on foreign capital utilization, wherein it emphasized a shift from "quantity" to "quality" of foreign investment, including plans to restrict environmentally damaging and

energy inefficient investments. Chinese Vice Premier Wu Yi said the shift in emphasis had also occurred because China had rectified its capital deficiency.

- *Macroeconomic controls:* Investment contributes an unusually large proportion of China's economic growth. Overcapacity may be building in some sectors, and the government is seeking to slow investment generally, according to U.S. State Department officials.
- *Currency stability:* Chinese government concerns exist about excessive foreign exchange inflows that could affect the appreciation of Chinese currency and money supply growth.
- *Political season:* In October 2007 the Chinese Communist Party held its Party Congress. According to U.S. and industry officials, government officials were hesitant to approve foreign mergers or acquisitions during the months leading up to the Party Congress. Large or politically sensitive deals were especially subject to being delayed, according to U.S. officials and industry representatives.
- *Other factors:* The equalization of tax rates for foreign and domestic enterprises, the impact of rising labor costs, and the influence of regulatory issues such as the new labor contract law.

Appendix VI: France



- France ranked fifth in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI stock in France totaled \$782.8 billion, an increase of approximately \$523 billion since 2000.
- FDI stock in France as a proportion of GDP in France was 35 percent in 2006.
- The United States is the leading investor in France, followed by Germany and the United Kingdom.

Background

France, as a member of the European Union, is subject to the articles of the European Community Treaty (EC Treaty). The articles relevant to foreign investment include the requirement that EU member states allow the free movement of capital, as well as allow investors from other countries to conduct business within the member state unencumbered.³⁵ However, under the EC Treaty, EU member states retain the right to impose restrictions on foreign investment based on public security considerations, as long as those restrictions do not result in arbitrary discrimination or a disguised restriction on trade.³⁶

Foreign Investment Laws and Policies

France regulates foreign direct investment for national security considerations through Decree No. 2005-1739, which implements Article L. 151 of the French Monetary and Financial Code. The 2005 Decree lists 11 specific sectors subject to foreign investment regulation on the grounds of defending France's public order, public safety, or national defense interests, as well as introduces a distinction between EU investors and non-EU investors, with a less restrictive regime applicable to the former.

³⁵ Articles 43, 48, 56, and 57 of the EC Treaty.

³⁶ More explicitly, the EC Treaty allows member states to "take any necessary measures for the protection of the essential interests of their security which are connected with the production of or trade in arms, munitions, and war material."

According to the French Monetary and Financial Code, financial dealings between France and foreign countries are unrestricted.³⁷ However, certain exceptions to this general policy relate to the regulation of foreign investment for national security considerations. The code states that the French government may require a range of foreign exchange transactions, which includes mergers, acquisitions, and other types of foreign investment, to be subject to prior approval by the French government if they may jeopardize public order, public safety, or national defense interests.³⁸ In addition, foreign investment in the research, production, and marketing of arms, munitions, or explosives is also subject to prior approval. Approval may be granted by the government based on conditions. Failure on the part of the investor to agree to these conditions may result in approval for the investment being denied.³⁹

European Court of Justice Ruling in 2000 Led to Current Regulations

In 2000, in a case brought before the European Court of Justice (ECJ), the ECJ ruled that France had violated the EC Treaty provisions on the free movement of capital.⁴⁰ France had restricted the transfer of funds from abroad to the French Church of Scientology, on the grounds that French public security interests were at stake. At the time, French law required an advance authorization for any foreign investment that might present a threat to public security—a requirement the ECJ found to be overly broad.⁴¹ As a result, France promulgated Decree No. 2005-1739, which implements Article L. 151-3 of the French Monetary and Financial Code, in December 2005.

The French decision to include gambling/casinos as one of the specified sectors subject to review, as well as the distinctions made between EU and non-EU investors, has caused further tension between France and the European Commission.⁴² The European Commission began infringement

³⁷ Article L. 151-1.

³⁸ Article L. 151-2.

³⁹ Article L. 151-3.

⁴⁰ C-54/99 (Eglise de Scientologie).

⁴¹ According to the ECJ opinion, the requirements of public security must be interpreted strictly, and public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society.

⁴² According to French government officials, gambling and casinos are used to launder money, which the French seek to prevent.

proceedings, and in October 2006, formally asked France to amend its regulations.⁴³ As of February 2008, France had made proposals to address the European Commission concerns, and discussions are ongoing.

Review Process

France's Ministry of Economy, Finance, and Employment leads the foreign investment review process. This ministry seeks input from various other ministries, including the Ministry of Defense, and issues an approval or denial based on the input of all government reviewers. Failure to apply for a national security review when required can result in criminal and civil penalties. If investors are unsure whether the proposed investment is subject to review they may request an opinion from the Ministry of Economy, Finance, and Employment. The ministry has 2 months to respond to the investor. However, the decree notes that a lack of response on the part of the ministry within the specified time frame does not release the investor from the review requirement.

The decree states that a review of an investment within a sensitive sector must be conducted if the investor will

- acquire "control" of a firm whose corporate headquarters are located in France,⁴⁴

⁴³The EC asked France to amend its regulations in part because France's regulations allowed for restrictions on investments by companies that are legally established in the European Union and have shareholders in non-EU countries, as indirect investments are subject to review under the French regime.

⁴⁴ According to French law 233-3, a company is deemed to "control" another company

- when it directly or indirectly holds a fraction of the capital that gives it a majority of the voting rights at that company's general meetings;
- when it alone holds a majority of the voting rights in that company by virtue of an agreement entered into with other partners or shareholders and this is not contrary to the company's interests;
- when it effectively determines the decisions taken at that company's general meetings through the voting rights it holds;
- when it is a partner in, or shareholder of, that company and has the power to appoint or dismiss the majority of the members of that company's administrative, management, or supervisory structures.

Further it is presumed to exercise such control when it directly or indirectly holds a fraction of the voting rights above 40 percent and no other partner or shareholder directly or indirectly holds a fraction larger than its own.

- acquire a branch of a firm whose corporate headquarters are located in France, or
- acquire more than one-third of the capital or voting rights of a firm whose corporate headquarters are located in France.

These conditions apply to investment from a non-EU company. Investment from a company that is based in the EU is subject to review when investing within a sensitive sector in France only when meeting one of the first two conditions above for the last four sectors listed below, and only when meeting the second condition for the first seven sectors of the list.

The decree defines the following sectors/activities as sensitive for purposes of a national security review:

1. gambling and casinos;
2. private security;
3. research, development, or production of means to stem the unlawful use, in terrorist activities, of pathogens or toxins;
4. equipment designed to intercept correspondence and monitor conversations;
5. testing and certification of the security of information technology products and systems;
6. production of goods or supply or services to ensure the security of the information systems;
7. dual-use items and technologies;⁴⁵
8. cryptology equipment and services;
9. activities carried out by firms entrusted with national defense secrets, in particular under the terms of national defense contracts or of security clauses;
10. research, production, or trade in weapons, ammunitions, powders, and explosives intended for military purposes or war materials;

⁴⁵ As listed in Annex IV of European Council Regulation No. 1334/2000 of June 22, 2000.

11. activities carried out by firms holding a contract for the design or supply of equipment for the Ministry of Defense, either directly or as subcontractors, to produce an item or supply a service for one of the sectors referred to in points 7 through 10 above.

Companies based in an EU member state are subject to the same scope of sectors/activities for 8 through 11 above as a non-EU state, but a more refined scope for sectors/activities 1 through 7 above.

The investor is asked to provide

- the location where the investor is a legal entity;
- details on the individuals and public legal entities that have ultimate control over the investing organization;
- the identity of the primary known shareholders holding more than 5 percent of the capital or voting rights;
- the board members' names and addresses;
- if the investor is an investment fund, the identity of the fund manager(s);
- the investment target's business activity;
- the investment target's last fiscal year revenues; and
- the shareholder structure before and after the contemplated deal.

If the Ministry of Economy, Finance, and Employment does not complete its review and respond within 2 months, then the transaction is considered to be automatically approved. However, the 2-month time frame only begins once a complete application is submitted. If more information from the investor is needed, the review period can be extended. According to French government officials, the Ministry of Economy, Finance, and Employment maintains an open dialogue with the investor so that the ministries reviewing a transaction can be assured of a complete understanding of the proposal. According to French government officials, during the approval procedure, informal consultations between the investor and the French government may take place. During this informal consultation, the investor may revise the proposal to obtain approval.

The decree states that the Ministry of Economy, Finance, and Employment may determine whether security concerns can be mitigated by attaching one or more conditions to the approval of a transaction. For example, according to French officials, the government might require that the investor commit to fulfill ongoing contracts or obligations of the target firm, particular sensitive technologies be kept within France, or aspects of a company's business that require the use of classified information be

limited to French citizens. Half of the cases reviewed in 2006 included mitigation agreements. According to government officials, it is common to require the investor to submit an annual report to the government confirming adherence to the agreement. Depending on the sector involved, the ministry with industry jurisdiction oversees the enforcement of commitments by the investor.

In the event that the Ministry of Economy, Finance, and Employment does not approve the transaction, the investor has the right under French law to appeal the decision in the French administrative courts. If the investor can demonstrate that the ministry failed to apply French law correctly, the negative decision may be overturned. In addition, the investor could challenge the decision before the European Court of Justice if EC Treaty provisions are thought to have been violated. According to French government officials, there has never been a denial, and consequently, there have been no appeals under the decree since it was promulgated in December 2005.

According to lawyers experienced with foreign investment policies in France, an important part of the application process for businesses is regularly following up with the Ministry of Economy, Finance, and Employment to check on the status of the application as it works its way through the review process. In a particularly sensitive deal, the investor is likely to hire advisers to contact the government to determine the likelihood of approval even before submitting an application for review. Lawyers and French government officials both stated that as a result of the explicitness of the decree, the French system is deemed to be relatively predictable and transparent for businesses because it is clear in the decree what is subject to review. U.S. government officials told us that they have not received any major complaints from U.S. businesses about French foreign investment policies or review procedures.

Other Foreign Investment Laws and Policies

In addition to the decree's requirements, France has a number of single-sector restrictions. For example, non-EU media companies are restricted from acquiring more than a 20 percent stake in French-language audiovisual communications and media companies, and foreign investment in the French banking and insurance sector requires approval from French banking and insurance regulators. The French government also reserves the right to restrict foreign-controlled enterprises in the aerospace sector. Finally, a number of public monopolies exist in France that are not open to investment, including atomic energy, railway

passenger transport, coal mines, gunpowder and explosives, and certain postal services.

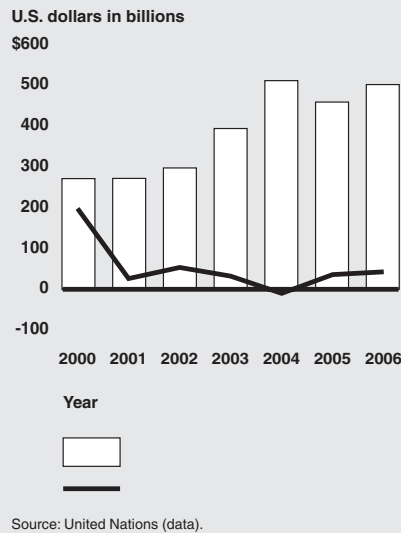
Recent Developments

According to a senior French government official, France is not philosophically opposed to foreign investment by foreign state-owned enterprises. However, it is informally considered in the investment review process. For example, the percentage of the investor that is owned by a foreign government would be taken into consideration. However, France does not have any laws or policies that specifically restrict state-owned enterprises or sovereign wealth funds from investing in France.

A growing concern in France is related to energy infrastructure security. For example, in June 2007 the French Parliament issued a report stating that the French government should consider whether energy should be added to the list of sectors in the decree that require government review and approval. As of February 2008, there was no legislation being discussed that provides for such an addition to the decree. A senior French government official also noted that while the use of French government golden shares is not targeted at foreign investors, the French government could use such a share to oppose any measure that might jeopardize the security of energy supplies—potentially including the purchase of French energy infrastructure by foreign state-owned enterprises, private hedge funds, or sovereign wealth funds.

Appendix VII: Germany

Foreign investment in Germany
(stocks and flows 2000–2006)



- Germany ranked fourth in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI in Germany totaled \$502.4 billion, an increase of 85 percent over FDI stock in Germany in 2000.
- FDI stock in Germany as a proportion of GDP was 17.4 percent in 2006.
- The United States is the third largest investor in Germany.

Background

Germany, as a member of the European Union, is subject to the European Community Treaty, including the requirement that EU member states allow the free movement of capital. EU members must also allow investors from other countries to conduct business within the member state unencumbered.⁴⁶ However, under the EC Treaty, EU member states retain the right to impose restrictions on the free movement of capital based on public security considerations, but these restrictions must not result in arbitrary discrimination or a disguised restriction in trade.⁴⁷

Foreign Investment Laws and Policies

In Germany, as a general rule, foreign investment is not restricted by the government. However, in 2004 Germany enacted Section 7 of the German Foreign Trade and Payments Act, which established exceptions to the free movement of foreign investment into Germany for the “protection of security and external interests.” Specifically, foreign investment may be restricted to guarantee the essential security interests of the Federal

⁴⁶ Articles 43, 48, 56, and 57 of the EC Treaty.

⁴⁷ Article 296.

Republic of Germany,⁴⁸ prevent a disturbance of the peaceful coexistence between nations, or prevent a major disruption of the foreign relations of the Federal Republic of Germany.⁴⁹ The act specifies that foreign investment transactions are subject to review if the transaction involves a German company that produces or develops war weapons and other military equipment, or produces cryptographic systems for the transmission of classified information.

German government officials told us that the catalyst for the 2004 amendments was the 2003 purchase of a majority stake in a German submarine manufacturer by a U.S. private equity investment firm.⁵⁰ According to these officials, there was uncertainty whether existing German export control laws were adequate to protect German national security interests, and the government did not possess the legal means to block such transactions. For example, the German government feared that a foreign company could purchase a German company possessing sensitive technologies, after which the investor could take the sensitive technology out of Germany and out of the purview of German export control laws.

After passage of the 2004 amendments to the act, the Federal Ministry of Economics and Technology issued implementing regulations specifying which transactions were subject to review. These included the acquisition of German companies, or the direct participation in such companies, that produce or develop items specified in Germany's War Weapons Control Act, such as

- missiles and rockets;
- combat aircraft and helicopters;
- vessels of war and special naval equipment;
- combat vehicles;
- barrel weapons (guns, cannons, howitzers, mortars, etc.);
- light anti-tank weapons, military flame throwers, mine laying and throwing devices;
- torpedoes, mines, bombs, explosives, etc.;
- related accessory and ancillary items; and

⁴⁸ What constitutes the essential security interests of Germany is not defined within Article 296.

⁴⁹ Foreign Trade and Payments Act of the Federal Republic of Germany, April 28, 1961.

⁵⁰ The firm subsequently sold its stake in 2004.

-
- laser weapons.

Acquisitions of companies that produce certain cryptographic systems are also subject to review under the implementing regulations of Section 7 of the act. Further, in September 2005, the German government added acquisitions of specialized engine and gear manufacturers to the list.⁵¹ According to lawyers experienced with foreign investment policies in Germany, this change occurred in response to the proposed sale of a German defense firm.

Review Process

The review of foreign investment in Germany is conducted by the Federal Ministry of Economics and Technology, which obtains input from the Ministry of Defense and the Ministry of Foreign Affairs, among others, on whether there are national security concerns. If the transaction involves a cryptography company, for example, the Ministry of the Interior and German intelligence services would also be involved with the review. The ministry may prohibit a given acquisition if the reviewing officials determine that there would be an essential security interest at stake if the transaction were to be allowed. According to German government officials, in general, approval is a consensus decision.

Non-German companies, as well as German companies in which a foreigner holds at least 25 percent of the voting rights, are subject to review if they are seeking to invest in one of the specified sectors and they are seeking to acquire a 25 percent or greater stake in the German company. If these criteria are met, the investor should report the transaction to the Federal Ministry of Economics and Technology. The investor submits a range of information about both the investor and the target company, including the following:

- proof of the businesses' legal domicile;
- whether the target company has classified information;
- a description of the business operations that fall under the War Weapons List, or cryptographic products;
- the companies' financial statements for the prior 3 years;
- the number of shares held, directly or indirectly, in the target company;
- a description of stakeholders in the companies who hold more than a 25 percent stake;

⁵¹ Specifically, companies that produce or develop motors or gear systems for combat tanks or other armored military tracked vehicles are subject to review.

- a listing of the major suppliers and customers of the target company for the prior 3 years; and
- a breakdown of the companies' market share in war weapons in the German market, in the EU market, and when known in the markets of non-EU countries.

Reporting foreign investment transactions to the German government is required. An investor's failure to notify the government may generate a fine and may be considered a criminal offense. German government officials noted that it is possible that a foreign investor could invest in Germany without obtaining ministry approval by not reporting the transaction. However, according to German government officials, companies commonly approach the Federal Ministry of Economics and Technology prior to formal application to gauge whether a given transaction is likely to be approved.

Under the act, the German government has 1 month to reach a decision after submission of a complete application to the Federal Ministry of Economics and Technology. Absent a decision, the transaction is automatically valid after the 1-month period. According to German government officials, they have not had problems completing a review within 1 month. Since the end of July 2004, when the new rules under the Foreign Trade and Payments Act for reviewing foreign investment came into effect, a total of 11 acquisitions have been reported for review.

The regulations do not permit government-imposed conditions on approval. However, according to German government officials, during the review process the ministry stays in contact with the applicant regarding any concerns or issues. If such issues are identified, the applicant can agree to make changes to the business arrangements outlined in its notification materials to facilitate an approval.

If the Federal Ministry of Economics and Technology were to deny an application, the decision can be appealed through an administrative process within the German legal system. To date, there have been no denials and, consequently, no appeals.

According to German government officials, about 50 companies constitute the core of the German defense industrial base. If an acquisition were attempted in relation to these companies, the investor would apply to the ministry to obtain approval. These officials estimated that roughly 800 companies in Germany could require approval for a foreign merger or acquisition on national security grounds if the German government were

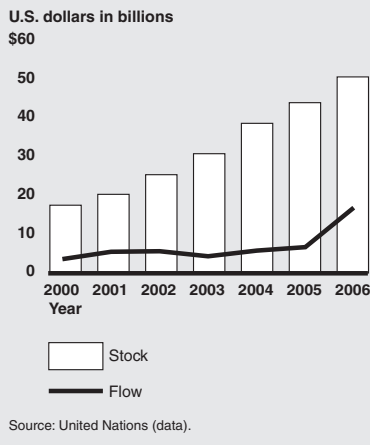
to extend the review requirement to all defense-related companies. The law currently does not include dual use items.

Other Foreign Investment Laws and Policies

In addition to Section 7 of the act, Germany has a number of single-sector restrictions. For example, ownership control provisions apply in the private television broadcasting sector. In addition, the German Banking Act requires an acquisition to be reviewed by regulators if an investor is interested in purchasing a controlling stake in a bank in Germany. Finally, a limited number of public monopolies exist in Germany, including inland waterways, employment services, and the lottery.

Appendix VIII: India

Foreign investment in India
(stocks and flows 2000–2006)



- India ranked 25th in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI in India totaled \$50.7 billion, an increase of \$33.2 billion over FDI stock in India in 2000.
- FDI stock in India as a proportion of GDP was 5.7 percent in 2006.
- India posted an average growth rate of more than 7 percent in the decade between 1996 and 2006.

Background

When India gained independence from British rule in 1947, the country welcomed foreign investment to establish a technology base as well as skills in entrepreneurship. In 1973, the Foreign Exchange Regulation Act (FERA) imposed a ceiling of 40 percent in foreign investment equity in Indian companies, leading to a flight of foreign investors. In the mid-1980s, India reversed course and began liberalizing its economy, including removing various restrictions on foreign investment. Further liberalization followed the announcement of a new Industrial Policy in July 1991. The Reserve Bank of India automatically approved foreign investment in industries designated by the government as priority recipients of investment. The Foreign Exchange Management Act of 1999 replaced FERA and removed restrictions on foreign corporations. Further, policies on licensing were liberalized.

While India has liberalized its foreign investment policy substantially since 1991, according to an Indian government official, the most important liberalization has occurred in domestic investment brought on by the privatization of the Indian economy. As the government continues to privatize state-owned sectors such as ports and energy production, India would like to attract both domestic and foreign private investment.

Foreign Investment Laws and Policies

The Foreign Exchange Management Act (FEMA) is one of the primary laws regulating foreign investment in India.⁵² FEMA broadly regulates the foreign exchange market and provides the Indian government the legal authority to restrict foreign investment. Because FEMA does not include implementing regulations, Indian foreign investment policy is primarily established through a series of public notices or “Press Notes” issued separately for each sector. Press Notes are usually approved by the government cabinet and released by the Department of Industrial Policy and Promotion (DIPP), a department within the Ministry of Commerce and Industry. DIPP makes all Press Notes publicly available and has published a comprehensive summary of the individual Press Notes.

The Press Notes establish, among other things, whether investments in each individual sector must receive government approval or whether investments fall under the “automatic route,” which does not require government approval. The Foreign Investment Promotion Board (FIPB) is an interagency body with the authority to approve investment transactions. Any proposed investment that requires government approval must receive approval from the FIPB before the transaction can be completed. In addition to investments in sectors specifically listed as requiring approval by the Press Notes, an investment must receive government approval if (1) the activity requires an industrial license, (2) the investment is in the financial sector or is subject to the Securities and Exchange Board, (3) the investor has an existing joint venture in India in the same field, or (4) the investment falls outside of ownership caps or in sectors in which foreign investment is prohibited. Investment that receives FIPB approval is granted the general permission of the Reserve Bank of India, which administers FEMA, without a separate approval process.

The Press Notes also establish the percentage of a company that can be owned by a foreign investor in each sector. Foreign ownership caps are usually set at one of the following levels: zero percent (prohibited), 26 percent (allowing the foreign investor a sufficient share to block major decisions), 49 percent (maintaining that a majority of shares are held by Indian nationals), 74 percent (maintaining that Indian nationals hold a sufficient share to block major decisions), or 100 percent (completely open). The reasons for the limits on foreign ownership vary from sector to sector. However, according to an Indian government official, domestic and

⁵² The other primary law relating to foreign investment is the Industries (Development and Regulation) Act of 1951, which is discussed later in this appendix.

economic concerns, such as the effect on Indian businesses, contribute to the restrictions. In some industries with primarily domestic concerns, such as retail trade, foreign investment is prohibited. However, it is allowed, within limits, in the defense industry, which is commonly associated with national security concerns.

The following are examples of sector-based ownership caps on foreign investment in India.⁵³

Foreign investment is prohibited in:

- retail trades (except single-brand retail),
- atomic energy,
- lotteries,
- gambling and betting,
- housing and real-estate business,⁵⁴
- certain types of agriculture.

Limited to 26 percent in (among others):

- defense industries,
- print media,
- insurance.

Limited to 49 percent in (among others):

- broadcasting,
- domestic airlines,
- infrastructure/service sectors.

Limited to 74 percent in (among others):

- establishment and operation of satellites,
- atomic minerals,
- exploration and mining of coal.

⁵³ With FIPB approval, investment can exceed the sector ownership caps in specific instances.

⁵⁴ Foreign investment is allowed in “integrated townships” including housing, commercial units, resorts and hotels. Foreign institutional investors can also invest in real estate Initial Public Offerings.

Allowed up to 100 percent in other sectors, including:

- development of airports,
- private oil refineries,
- nonatomic electricity generation,
- roads and highways.

Ownership caps are independent of government approval requirements. For example, a sector open to 100 percent foreign ownership may still require government approval, while a sector capped at 49 percent may be open through the automatic route. There are no stated monetary thresholds that trigger a review of foreign investment, except for certain currency transactions, which must be reviewed by the Reserve Bank of India at various thresholds.

Foreign investors under the automatic route are only required to notify the Reserve Bank of India within 30 days of completing the transaction. According to a government official, the notification information is primarily for statistical purposes. All foreign investment transactions require notification, regardless of value or equity percentage, although according to a government official, there are no measures in place to ensure compliance with the notification requirement. According to an Indian government official, potentially harsh penalties for noncompliance deter investors from avoiding requirements.

Some sectors have additional restrictions and approvals. The Industries (Development and Regulation) Act of 1951 currently requires industrial licenses for several sectors, including alcoholic drinks, tobacco, electronic aerospace and defense equipment, industrial explosives, and hazardous chemicals. An industrial license was also required for a manufacturing plant with capital of more than 10 million rupees (roughly \$250,000) to produce any of the 114 items that are reserved for “small scale” producers (under 10 million rupees) as well as for any industrial project within 25 kilometers of any city with a population of 1 million or more as of the 1991 census. According to the U.S. State Department, the government of India recently reduced the number of small scale reservations from 114 to 35, part of an incremental reduction that is expected to continue. Investments in these sectors must receive an industrial license in addition to approval from the FIPB.

In addition to the required FIPB review and approval for foreign investment, investment in the financial sector is subject to approval by the Reserve Bank of India. Guidelines for FIPB reviews state that for private

sector banks, FIPB approval would be granted only after permission had been obtained, in principle, from the Reserve Bank. These guidelines are included in a document entitled *Investing in India: a Comprehensive Manual for Foreign Direct Investment-Policy and Procedures*, published by the Indian government.

Foreign institutional investors such as mutual funds are regulated by the Securities and Exchange Board of India Act as well as under FEMA. While foreign nationals are not allowed to invest directly in the Indian stock market, foreign institutions that are regulated in their home country are allowed to invest, subject to certain rules, according to the Indian government. For example, no single foreign institutional investor can acquire more than 10 percent of an Indian company, and all foreign institutional investment cannot exceed 24 percent of the capital of the Indian company. Foreign institutional investors must also receive approval from the Reserve Bank in some instances, such as non-stock exchange sales and purchases. According to a law firm familiar with foreign investment policies in India, the Securities and Exchange Board of India regulations are much less demanding than those under the FIPB approval process. In 2006, India amended the Securities and Exchange Board of India regulations, expanding the list of entities considered foreign institutional investors, which are allowed to invest in the Indian stock market, to include governmental agencies such as sovereign wealth funds.

Review Process

For those transactions that do not qualify for the automatic route, the FIPB has the authority to reject an investment transaction, and judges each proposal on a case-by-case basis. FIPB can reject a transaction based upon “special circumstances” or on factors it considers relevant, according to FIPB guidelines. While the guidelines emphasize FIPB’s flexibility, they also offer nonbinding factors that FIPB should consider in a review. For example, FIPB should consider whether an investment has any strategic or defense-related considerations. However, the FIPB guidelines do not specify what would constitute a strategic or defense related consideration. An Indian government official stated that while an FIPB review could consider other factors, the primary focus of a review is to determine whether the proposed investment is compliant with Indian policy, such as sector equity caps, joint venture approval requirements, and industrial licensing requirements. According to an Indian government official, in most cases, FIPB denies approval only if a transaction is not compliant with Indian foreign investment policy requirements.

The FIPB is composed of the Secretaries of the Department of Economic Affairs (the Chair), the Department of Industrial Policy and Promotion, the Department of Commerce, the Division of Economic Relations within the Ministry of External Affairs; and the Ministry of Overseas Indian Affairs. According to an Indian government official, the ministry with industry jurisdiction for each case contributes to the FIPB decisions. Guidelines suggest that applications submitted to specific ministries should be brought before the FIPB within 15 days of submission, and that government approval or rejection should be communicated within 30 days. However, according to an Indian government official, an investor should plan on a 3-month review and approval process. Investors may file grievances or complaints to the Grievances Officer-cum-Joint Secretary within the DIPP or to the Business Ombudsman within the Ministry of Commerce and Industry. Once an investor has received approval through the FIPB, he or she is automatically granted the general permission of the Reserve Bank without additional review; however, the companies must notify the Reserve Bank within 30 days of receipt of inward remittances and within 30 days of the issue of shares to the foreign investors.

According to a lawyer familiar with investment in India, FIPB approval is usually a legal formality, and FIPB denials are rare. FIPB does not place conditions upon approval. However, according to a U.S. State Department official, if the investment application requires modification, an investor is permitted to resubmit an amended investment application to the FIPB for approval. Proposals can also be deferred or referred to a different regulatory body.

Government ministries can exert influence on investment transactions prior to the transaction entering the formal FIPB process. According to a U.S. State Department official, the Indian government has intervened in a number of cases where investors from countries of concern have attempted to invest in sectors deemed sensitive, such as the telecommunications sector, often through involvement from the ministry with industry jurisdiction on an ad hoc basis rather than through the formal process. Negotiations and informal discussions with the ministries occur before an investor submits an application to the FIPB, according to the U.S. State Department. Furthermore, some investment applications to the FIPB from investors in countries of concern have sat for over a year without approval or denial, according to a U.S. State Department official.

New Developments

Indian foreign investment policy in individual sectors changes frequently. Each year, the Indian Cabinet reviews foreign investment policy and

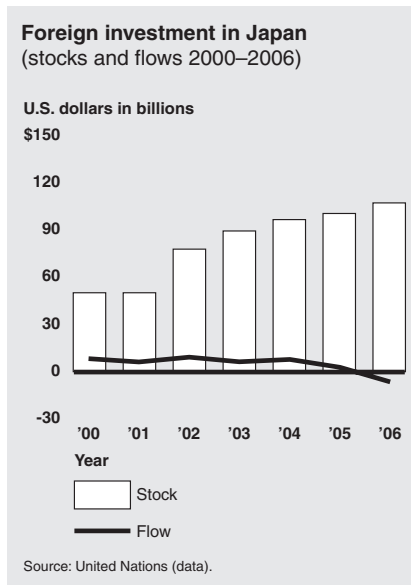
announces a series of sector-based changes as part of a government-wide FDI review, according to the U.S. State Department. In January 2008 the Indian government approved several changes to its FDI policy. The limit on foreign investment in state-owned petroleum refineries was increased from 26 to 49 percent. The limits in some parts of the civil aviation sector, including cargo airlines, were increased from 49 to 74 percent, although investment in passenger airlines is still limited to 49 percent. Additional liberalization of foreign investment rules was approved for construction development projects, commodity exchanges, credit information companies, industrial parks, and titanium mining. According to the U.S. State Department, the cabinet-approved policy, which was delayed several months, dropped the most controversial proposals to expand FDI in retail and other areas. Changes to individual sectors also can occur outside the annual foreign investment policy review, according to the U.S. State Department. For example, in April 2007, the government announced changes to the conditions of ownership in the telecommunications sector as a follow-up to changes made in March of 2005 that increased the telecommunications sector ownership cap from 49 percent to 74 percent. The 2007 changes introduced additional specific security conditions for the telecommunications industry, which, according to business association representatives, are intended to offset potential security concerns associated with increased foreign ownership in the sector.

According to business representatives that have had experience investing in India, there have been no recent significant changes that have tightened controls on foreign investment or increased ownership restrictions. Indian government officials as well as representatives from a law firm with Indian investment experience stated that the trend of liberalization will continue in India. Despite a likely trend of liberalization in the long term, one of the most controversial areas for liberalization has been in the retail sector, where foreign investment is seen as a threat to small Indian retail businesses. According to the U.S. State Department, The Ministry of Commerce and Industry announced in October 2007 that liberalization in the retail sector would not occur as part of the ongoing foreign investment policy review.

The Indian government has also recently considered implementing a security-based review process. According to the U.S. State Department, the Indian National Security Council Secretariat suggested creating a National Security Exception Act (NSEA), which would have established a process for assessing security threats related to foreign investment, similar to the U.S. CFIUS process. The idea met resistance from the Ministry of Commerce and Industry and the Ministry of Finance and was subsequently

abandoned. The debate over the changes represents the institutional differences between agencies. The National Security Council Secretariat and the Ministry of Home Affairs would prefer to make security controls an explicit part of the formal process, while the Ministry of Commerce and Industry and the Ministry of Finance are concerned about the effect on investment that further review requirements might have, according to the U.S. State Department. Since the initial proposal was abandoned, U.S. State Department officials have reported that Indian government agencies are still debating the need for a national security review of foreign investment.

Appendix IX: Japan



- Japan ranked 37th in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI in Japan totaled \$107.6 billion, an increase of \$57.3 billion over FDI stock in Japan in 2000.
- Japan is ranked 21st in the world in terms of FDI stock as of 2006.
- FDI stock in Japan as a proportion of GDP was 2.5 percent in 2006.

Background

Japan possesses the third largest economy in the world. However, foreign investment is significantly less in Japan than for other large economies. In 2003, the Japanese government set a national goal of doubling the nation's stock of foreign investment from its 2001 level by the end of 2006. In March 2006, the Japanese government set an updated goal that has been officially adopted by the cabinet to increase foreign investment in Japan to 5 percent of the country's GDP by 2010.

Trends of foreign investment in the Japanese economy are best understood within the historical context of the Japanese recovery after World War II, according to an academic familiar with the Japanese economy. Whereas countries such as West Germany and France emerged from the war and took measures to attract foreign capital to rebuild, Japan has historically had a surplus of capital and therefore little need to attract foreign investment, according to a consultant on Japanese financial and trade-related issues. Japan enacted the Foreign Exchange and Foreign Trade Act (FEFTA) in 1949, which, according to an academic, barred foreign companies from repatriating profits from Japan, effectively prohibiting all but a few cases of foreign investment. This continued until 1967, at which time Japan was required to open its economy to foreign investment to become a member of the OECD. Japan further changed its laws in 1991, by amending the Foreign Exchange and Foreign Trade Act, which today remains the primary law relevant to FDI. However, despite changes in the law, foreign investment did not increase substantially until the economic downturn in the late 1990s; this increase in foreign

investment is the result of bankrupt companies seeking foreign investors in order to stay afloat, according to U.S. State Department officials and representatives from the private sector and academia.

Officials also offered multiple explanations for why foreign investment in Japan has been low. One explanation is that foreign acquisitions of Japanese companies face barriers caused by business practices such as cross-shareholding—the practice of companies holding shares of each other’s stock—and *keiretsu* relationships—groups of affiliated companies that hold each other’s shares and may also have financial (such as bank loans) or manufacturer-supplier ties or distributor relationships. Cross-shareholding and *keiretsu* relationships lessen the amount of shares available on the stock market. In addition, cross-shareholding may prevent a foreign company from taking management control of a company, even if the foreign company is the largest individual shareholder. The Japanese government notes that *keiretsu* relationships and cross-shareholding have become less common than they were in the past. Another explanation is that Japanese businesses are averse to foreign investment. One reason for that is because Japan possesses a system of guaranteed lifetime employment, which has led Japanese business managers to place a greater value on internal corporate loyalty than shareholder returns, according to the U.S. State Department. Many Japanese companies believe that foreign investors, especially private equity firms, will harm a Japanese company’s long-term business interests solely to increase short-term profits, according to an academic and private sector representatives.

In addition to a business environment generally averse to foreign investment, companies have increasingly instituted corporate defensive measures to prevent hostile takeovers by both foreign and domestic companies as a response to revisions of Japan's Corporate Code that expanded the types of merger and acquisition transactions allowable in Japan. Defensive measures such as “poison pills” allow a corporation to prevent a hostile takeover at the cost of diluting the value of all shareholders’ holdings. In May 2005, the Japanese government released guidance on how to appropriately implement defensive measures. As of May 2007, about 340 companies in Japan had instituted such defensive measures. In at least one case, the Japanese courts have upheld the right of a Japanese firm to prevent a foreign acquisition using defensive measures, according to industry association representatives.

Since the 1990s, acceptance of foreign investment has increased, although high-profile cases have fueled a fear of foreign investment, according to U.S. government officials. In the economic recession in the 1990s,

Japanese companies in financial distress needed foreign investors to prevent bankruptcy, according to an academic. In fact, foreign investment mergers and acquisitions in Japan have typically occurred only when the Japanese company is in financial distress, according to a business association representative. While there have been successful transactions that have benefited the investor and the Japanese company, some foreign investment transactions have been viewed as harmful to Japan, according to an academic familiar with the Japanese economy. One such case involves a foreign private equity firm's acquisition of a bank and subsequent large initial public offering (IPO) for the private equity firm. This company forced another Japanese company to declare bankruptcy while producing a large profit for itself, a fact that contributed to the view that foreign firms do not share Japanese interests.

Foreign Investment Laws and Policies

Japan's primary law concerning foreign investment, is the Foreign Exchange and Foreign Trade Act.⁵⁵ The law provides that government ministries may prohibit or place conditions on a proposed foreign investment if they determine that it may harm national security, public order, public safety, or the smooth management of the economy. However, the Japanese government has not used this authority since FEFTA was amended in 1991, according to the Japanese government.

The Japanese regulatory scheme established under FEFTA treats foreign investment differently based upon the sector in which the investment is taking place, among other criteria. Foreign investment in a sector that is determined to be sensitive requires prior notification and government approval, while investment in other sectors only requires an after-the-fact notification to the government. Foreign investment in all industries requires notification through one of these routes. A government notice provides tables that specify the sectors and the individual industries that require prior and after-the-fact notification. Industries not listed in either table must submit prior notification. Failure to notify, among other violations under FEFTA, can result in criminal penalties including jail for up to 3 years and/or a fine of three times the investment amount or 1 million yen, whichever is larger.

⁵⁵ The law has been referred to by GAO in a past report as the Foreign Exchange and Foreign Trade Control Law (FECL). GAO is currently using the translation of the law released by the Office of the Cabinet Secretariat of the Japanese government.

According to the Japanese government, prior notification of a foreign investment is required for

- national security: aircraft, weapons, nuclear power, spacecraft, and gunpowder;
- public order: electricity, gas, heat supply, communications, broadcasting, water, railroads, passenger transport;
- public safety: biological chemicals, guard services; and
- smooth management of the economy: primary industries relating to agriculture, forestry and fisheries, oil, leather and leather products manufacturing, air transport, and maritime transport. (These areas are reserved under Article 2 of the OECD Code of Liberalization of Capital Movements.)

Prior notification is also required in additional circumstances. The Japanese government requires prior notification for investments from countries with which Japan has not completed a reciprocal investment agreement⁵⁶ and if the foreign investment involves certain capital transactions subject to permission by the Finance Minister.⁵⁷ If there is doubt as to whether a company is subject to prior notification, administrative agencies will provide an advance consultation outside of the formal review process.

On September 28, 2007, a Japanese Cabinet Ordinance came into effect, requiring that industries for dual use items and items used for the maintenance of the defense industrial base provide prior notification for foreign investment. These changes were based on recommendations of a study group convened by the Ministry for Economy, Trade, and Industry (METI), according to the Japanese government. The change was intended to prevent the outflow of technology, especially that which has a high probability of conversion to use in weapons of mass destruction, and maintain the domestic defense industrial base. The revisions include a list of all specific industries and items that fall under the new prior

⁵⁶ Specific countries that have conducted reciprocal investment agreements are listed in the ordinance implementing FEFTA.

⁵⁷ Specifically, FEFTA requires prior notification for capital transactions that (1) may disturb fulfillment of an international agreement or contribution to international peace by Japan; (2) might make the maintenance of Japan's balance of international payments difficult; (3) might result in the drastic fluctuation of Japan's foreign exchange rates; or (4) transfers funds between Japan and foreign countries in a large volume, and thereby might adversely affect Japan's financial or capital market.

notification requirements, including industries involved in making accessories or components related to the manufacture of arms, aircraft, satellites, and nuclear reactors. Additionally, manufacturers making testing equipment, repair equipment, and certain types of software usable in weapons and airplanes will fall under prior notification requirements.

According to the Japanese government, the review of foreign investment regulations was initiated because of the changed security environment surrounding Japan and trends in international investment activity. This was the first review of foreign investment regulations in 16 years, since FEFTA was amended in 1991. While there was no single triggering event for these changes, there were several controversial investments, both domestic and foreign, that have raised public concern with mergers and acquisitions over time, according to U.S. State Department and industry association representatives.

A foreign investor in sectors that require after the fact reporting must file a report with the Ministry of Finance and the ministry with jurisdiction over the industry through the Bank of Japan within 15 days after a transaction occurs. In previous interviews with Japanese government officials, GAO was told that this reporting was for statistical purposes and in case of an emergency, such as a financial crisis or war.⁵⁸

FEFTA broadly defines “foreign investment” as the (1) acquisition of at least 10 percent foreign ownership of shares in a company listed on a Japanese stock exchange; (2) acquisition of any shares in an unlisted company; (3) establishment of a branch, factory, or other business office in Japan; (4) consent given to change the corporate objectives of a domestic company with one-third or more foreign ownership; or (5) loan of certain types and amounts of money to domestic companies.

In addition to adding industries subject to prior notification and review, the September 2007 Cabinet Ordinance made several other changes. It expanded the scope of FEFTA to include investment in a parent company when a subsidiary falls under a sector that is subject to review and provided clarification on the percentages of foreign ownership that fall under the regulations. If more than 50 percent of a company is controlled by foreigners, but no single foreign investor owns more than a 10 percent

⁵⁸ GAO, *Foreign Investment: Foreign Laws and Policies Addressing National Security Concerns*, [GAO/NSIAD-96-61](#) (Washington D.C.: Apr. 2, 1996).

share, that investment will not fall under FEFTA regulations. However, if 10 percent of the company is owned among separate investors that have agreed to collectively exercise their voting rights, the investment will be subject to FEFTA regulations. Also, the ministries can request detailed information from the foreign investors and the target company; under previous regulations, such information was available only if the investor supplied it voluntarily.

In addition to the review process implemented under FEFTA, there are specific restrictions to other sectors. According to OECD, foreigners or foreign-controlled enterprises are not granted licenses in the broadcasting sector (except cable television and broadcast on telecommunications services) under the Radio Law and Broadcast Law, which were both passed in 1950. Similarly, the 1984 Law Concerning Nippon Telegraph and Telephone Corporation requires that board members and auditors of the Nippon Telegraph and Telephone Corporation have Japanese nationality. Also, the Japanese government is obligated to hold stocks in Japan Tobacco Inc.

Review Process

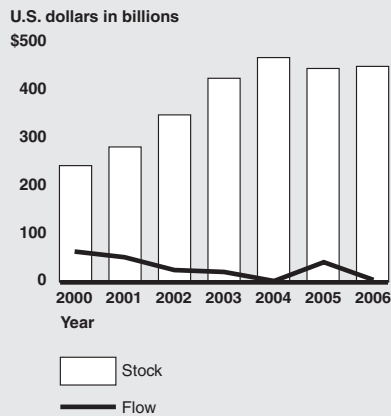
FEFTA authorizes the Ministry of Finance and the ministry with industry area jurisdiction to review investments that are required to provide prior notification. The notification form requires information on the percentage of shares to be acquired, the business plan of the investing company, and the reason for the transaction. However, the ministries may also consider information related to foreign control, such as the number of foreign board members and the foreign company's reputation, according to Japanese government officials. The ministries review investments on a case-by-case basis. While threats to national security, public order, public safety, or the economy are factors considered in a review, specific criteria used to determine when an investment poses a significant threat are not published.

The ministries have 30 days to review a proposed investment after a foreign company has notified the ministries of its intent to invest. If the investor has not received a response within that time, the transaction is automatically approved, according to METI officials. The ministries may extend the review period up to 4 months if they believe further inquiry is necessary. A Committee on Foreign Exchange and Other Transactions also may extend the review period an additional month. However, the Japanese government noted that reviews can be, and frequently are, shortened to 14 days. Japanese law provides for a public hearing if an investor wishes to contest the result of the ministerial review. After the public hearing, an

investor may submit an administrative appeal to overturn the decision and if the appeal is rejected, an investor can then request the court to overturn the decision.

Appendix X: The Netherlands

Foreign investment in Netherlands
(stocks and flows 2000–2006)



Source: United Nations (data).

- The Netherlands ranked eighth in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI in the Netherlands totaled \$451.5 billion, an increase of 85 percent over FDI stock in 2000.
- FDI stock in the Netherlands as a proportion of GDP was 68.2 percent in 2006.

Background

The Netherlands' trade and investment policies are among the most liberal in the world. As a founding member of the EU and the home of the International Court of Justice, the Netherlands has historically emphasized the development of international institutions and maintains an economy with a strong international focus. The Netherlands Constitution is one of only two constitutions in the world to include a provision requiring the government to further international institutions and the rule of law.⁵⁹ According to lawyers familiar with foreign investment policies in the Netherlands, there were a series of significant changes in Dutch corporate law in the 1980s that favored corporate shareholders. The changes were largely reactions to the broad social policies of the 1960s and 1970s. These revisions to the law, combined with the fact that the Netherlands has a highly educated population, have made the country a prime target of investment over the past several decades. Foreign companies established in the Netherlands account for roughly one-third of industrial production and employment.

Foreign Investment Laws and Policies

The Netherlands possesses no review process for foreign investment, and according to Dutch government officials, the Netherlands lacks the general authority to block investment. Foreign and domestic companies are treated equally under Dutch law, and regulations for mergers and

⁵⁹ The second constitution that includes this provision is the Constitution of Surinam.

acquisitions apply to domestic as well as foreign investment, according to Dutch government officials.⁶⁰ Foreign investment, like domestic investment, must go through an anti-trust review. However, these reviews do not provide the Dutch government the authority to block investment upon national security grounds, according to government officials. The one exception is in the financial sector, in which the Netherlands Central Bank, and in some cases the Finance Minister, can block mergers and acquisitions.

The Financial Supervision Act establishes the authority for the Netherlands Central Bank to review and grant approval to all mergers and acquisitions involving Dutch companies in the financial sector, including banks, management companies for collective investments, investment firms, and insurance companies. For a transaction involving one of the five largest banks in the Netherlands, the transaction must receive approval from the Ministry of Finance. When a company acquires at least 10 percent ownership of a Dutch company, the investor must apply to the Netherlands Central Bank to receive a “declaration of no objection.” According to Dutch government officials, this application can be submitted after a transaction has been completed. The Netherlands Central Bank performs a review of the transaction and decides whether or not to issue a declaration of no objection. In the case of the five largest banks, the Netherlands Central Bank makes a recommendation to the Finance Minister, who has the authority to issue the declaration of no objection. The Netherlands Central Bank or the Finance Minister can effectively block a transaction by refusing to issue this declaration. The Bank or Finance Minister has 3 months from the date of application to render a decision.

The review and approval process in the financial sector is primarily intended to determine whether any financial mergers or takeovers would lead to undesirable developments in the Dutch financial sector. According to Dutch government officials, the process is not generally treated as a review or approval process at all; rather, it is a contractual agreement whereby acceptable conditions of the merger are established. However, the Financial Supervision Act states that the government of the Netherlands has the authority to provide “prudential supervision” of

⁶⁰ The only Dutch exception to the principle of national treatment is in air transport. As in the United States, bilateral and multilateral agreements provide nationality and ownership requirements for Dutch airlines.

mergers, and according to a Dutch law firm with experience facilitating investment in the Netherlands, this review provides a general discretionary authority to deny transactions so long as a decision is supported on reasonable grounds. According to the law firm, if there is a threat to national security, the Netherlands Central Bank or the Finance Minister could block a transaction using this authority. According to Dutch government officials, a situation in which foreign transactions could be blocked would be if there was spillover from U.S. sanctions. For example, investment from businesses in countries such as Venezuela and Iran may be determined to harm the functioning of the Dutch market and could thus be blocked.

Restricted Sectors

Certain sectors are publicly owned and controlled, and are therefore closed to foreign investment. According to a Dutch government official, public monopolies exist in the following instances:

- A state-owned enterprise owns and administers the national high-voltage electricity grid. However, electricity production and distribution are open to foreign investment.
- Water grids are locally held monopolies. While some water grids have been privatized to foreign entities, new legislation passed in 2004 prevents further privatization. According to Dutch government officials, water is maintained by the government primarily due to health concerns.
- Railway passenger services are controlled by a state-owned enterprise and are effectively closed to investment.
- The national airport is currently closed to investment. While privatization has been discussed for years, the current government has decided not to privatize the airport.
- The Netherlands Central Bank is a monopoly and is closed to investment.
- Postal service below 50 grams per letter is closed to investment. This monopoly is still in place, but is slated to be abolished by December 31, 2010, as part of a decision to abolish this monopoly in most of the European Union nations.
- Public bus transport is generally open to foreign investment, although within some cities, the bus lines are owned by the local government.

Dutch government officials generally cited maintaining a competitive market as a reason why these sectors are closed to investment. Dutch government officials noted that privatizing sectors where there is a monopoly would present a threat to open competition in the market.

However, Dutch government officials also cited other reasons for the government maintaining control of sectors, such as the fact that the water grids could present a health issue if not properly maintained. All of the listed restrictions fall under the transportation, water supply, energy, or banking sectors, which are considered part of “critical infrastructure” by U.S. government sources. According to a U.S. State Department official, one reason these sectors are protected in the Netherlands is that they are perceived by the Dutch to be vital to their security interests.

The Netherlands has imposed nationality requirements in the air transport industry. European Union law requires that an airline registered and licensed in the Netherlands must be majority owned and controlled by EU nationals. In 2004, an airline from another EU member state acquired the Dutch national airline and maintains a majority share in the combined company. Despite the fact that the partner investor is another European airline, the Netherlands recently renewed the right to dilute shares to acquire 50.1 percent of voting rights in the case that another nation terminates or restricts an international route because the airline is not effectively controlled by Dutch nationals.

New Developments

The Netherlands currently has no plans to change its laws for managing foreign investment, according to U.S. State Department officials. However, some members of the Dutch government have argued that changes should be made. High-profile transactions have raised concerns with foreign investment among certain factions in the Netherlands. According to U.S. State Department officials, the debate about whether the Netherlands should institute stricter controls on foreign investment was first raised with the acquisition of the Dutch national airline in 2004. Some people believed that certain traditionally Dutch companies should stay in control of Dutch nationals, according to U.S. State Department officials.

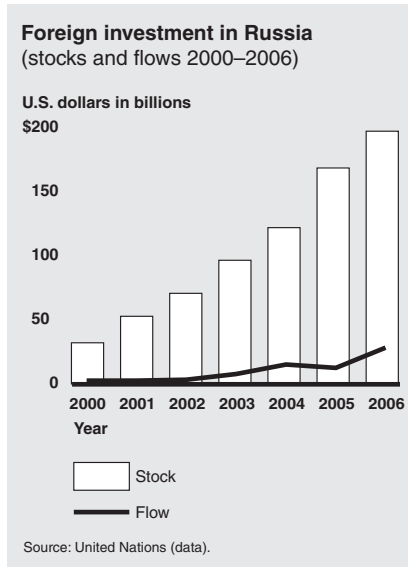
The negotiations involving the acquisition of a Dutch bank by foreign investors has reopened the debate concerning the protection of Dutch companies from foreign acquisitions. The terms of the acquisition of the bank by foreign investors were approved by the Ministry of Finance and were recently finalized. However, some members of Parliament have expressed concern about the transaction and announced a desire to debate both the specific transaction as well as potential changes to the entire regulatory scheme for granting approvals. While the Parliament has not intervened in the regulatory process, the Finance Committee within the Dutch Parliament planned to debate the bank transaction on October 17, 2007, and again on November 8, 2007. According to U.S. State

Department officials, one change suggested by Dutch government officials has been to increase the role of the financial supervisor, effectively delegating a body within the government to oversee mergers and acquisitions. Another suggestion has been to reintroduce golden shares in certain domestic companies. Golden shares would grant the government veto rights over substantial changes to particular companies that have been determined to serve the public interest. The Netherlands divested its golden share in the national postal firm in 2006 after the European Court of Justice ruled that the golden share unduly restricted the free movement of capital.⁶¹

The bank transaction also raised concerns about state-owned enterprises and sovereign wealth funds. A failed bidder for the Dutch bank was partially owned by a state-owned bank from China and a sovereign wealth fund from Singapore. Had the transaction been completed, a minority share of the Dutch bank would be indirectly owned by the Chinese and Singaporean governments. This fact, according to a Dutch law firm familiar with the transaction, concerned members of the Dutch Parliament and was one reason for calls for debate over the bank transaction. However, the Netherlands has typically not been opposed to investment from government-controlled investors, and according to Dutch government officials, there are already state-owned enterprises that have invested in companies in the Netherlands.

⁶¹The European Community Treaty allows for countries to restrict the free movement of capital in cases determined to be justified on public policy or public security grounds.

Appendix XI: Russia



- Russia ranked 18th in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI in Russia totaled \$197.7 billion, an increase of more than \$165.5 billion over FDI stock in 2000.
- FDI stock in Russia as a proportion of GDP was 20.2 percent in 2006.

Background

In 1991, Russia began its transition from a centralized command economy to a market-based economy and thus has less than two decades of experience with foreign investment. Roughly three-quarters of the Russian economy has been privatized, although the state continues to hold blocks of shares in many privatized enterprises. According to U.S. business representatives and lawyers in Russia, business ventures have become more complex since the earliest days of the opening of the country to foreign investment. According to the U.S. State Department, while the Russian economy has begun to diversify and institute economic reforms, the government budget and economy continue to be dependent on oil and gas revenues. About 40 percent of investment in Russia is in the energy sector. Other sectors receiving foreign investment are transportation, real estate, services, machinery, banking, and retail. The Russian government recognizes the need to promote new investment in aging infrastructure and believes it can do this through controlling strategic enterprises, state-sponsored investment funds, special economic zones, and limiting foreign investment in key strategic sectors.

Foreign Investment Laws and Policies

Under the 1999 Federal Law on Foreign Investments, the Russian government may block foreign investment to ensure the defense of the country and the security of the state. However, according to Russian government officials, no regulation or process was put in place to implement that section of the law. Two transactions with national security implications were attempted in 2004 and 2005. The Russian government

reviewed the transactions using an ad hoc process in which the Federal Anti-Monopoly Service (FAS) received the investors' applications for an anti-monopoly review and then coordinated a review through the Russian government's security ministries. One transaction was eventually approved and one was not. As a result of these attempted investments, the Russian President's 2005 State of the Russian Federation speech called for legislation to formalize a process to protect Russia's interests by reviewing foreign investment in sensitive economic sectors, according to Russian government officials.

In response, according to Russian government officials, the Ministry of Economic Development and Trade and the Ministry of Industry and Energy, in conjunction with the Russian presidential administration and the Russian security services, developed the proposed Strategic Sectors Law—which, according to a senior Russian government official, resembles certain aspects of the U.S. CFIUS process. Several versions of the legislation have been drafted; one version went to the Russian Duma for approval in July of 2007. According to the U.S. State Department, a more restrictive version of the Strategic Sectors Law and relevant amendments to the Subsoil Law were announced by the Russian government on February 21, 2008. As of February 26, 2008, the Strategic Sectors Law had not been passed, and is subject to change. The new draft of the Strategic Sectors Law and the Subsoil Law amendments could be considered by the Duma in the spring of 2008.

The Russian legal system is based on civil, not common, law. As a result, according to a senior Russian government official, Russian laws are more detailed than might be the case under a common law system. This official noted that this characteristic of civil law systems partially explains the degree of detail that is found in the proposed Strategic Sectors Law. In addition, Russia's basis in civil law also helps illuminate why the lack of implementation procedures in the 1999 Federal Law on Foreign Investments in Russia was particularly problematic.

Review Process

According to Russian government officials, under the current system, the Federal Anti-Monopoly Service is the only government entity with explicit authority to approve foreign investment transactions. The current process requires investors to submit applications for anti-monopoly review to the FAS. The FAS determines whether the investment may cause a national security concern, in addition to its primary role of determining anti-monopoly considerations. The FAS solicits input from other members of the Russian federal government on whether the proposed transaction

should be approved or blocked, and delivers the decision to the investor. According to Russian government officials, this ad hoc process was developed out of necessity, it is not a process intentionally crafted to most effectively protect Russian national interests, and it is a painful process for foreign investors because of the lack of transparency.

Thresholds for Mandatory Review

Under the 1999 Federal Law on Foreign Investments, application for FAS review of foreign investment is mandatory when a proposed transaction meets certain thresholds. For example, if the aggregate value of the assets of the merged or acquired entities exceeds 3 billion rubles, if the aggregate revenues of the entities will exceed 6 billion rubles, if the entities control more than 35 percent of the market, or if the investor seeks to obtain more than one-third of the shares in a company, then prior approval of the investment by the FAS is required. According to U.S. industry officials in Russia, in cases where the thresholds are not met, the investor may need to notify the FAS of the transaction, but not necessarily obtain prior approval.

Standard Review Time Frames

Under the current FAS anti-monopoly review, the standard time frame for review, upon receipt of the complete investor application, is up to 30 days. These 30 days are for conducting the FAS review, and do not incorporate a standard time frame for conducting national security reviews. Because national security reviews under the current process are ad hoc, they have no set time frames. For example, according to an industry official, in one case, which did ultimately receive approval, it took over 7 months for a final decision to be reached. During this period, the investor provided the Russian government with supplemental materials to the FAS review packet, in addition to holding meetings with Russian government entities.

Use of Mitigation Agreements

While the current FAS anti-monopoly review process is not technically designed to mitigate potential concerns that arise during the ad hoc national security review of foreign investment, in practice the signing of mitigation agreements has occurred between the Russian government and the applicant investor to enable the approval of a transaction.

Judicial Appeal of Review Decisions

According to lawyers experienced in foreign investment in Russia, a denial issued by the FAS under the current anti-monopoly review process can technically be appealed through the Russian judicial system. However, these lawyers do not believe that an appeal attempt is likely to be successful, unless the investor presents information that was not included in the original application.

New Developments

The Russian government's Ministry of Economic Development and Trade and the Ministry of Industry and Energy, in conjunction with the presidential administration and the security services, developed a new Strategic Sectors Law. The new draft of the law could be considered by the Duma in the spring of 2008, according to the U.S. State Department. If passed, the law will create an interagency review process for foreign investment. The July 2007 version of the proposed Strategic Sectors Law specified 39 sectors that are considered sensitive. Among other changes, the February 2008 version of the draft combined some sectors and added four strategic sectors to the list.

Under the proposed law, investors would still apply to the FAS for an anti-monopoly review, but would also be subject to a separate review if the proposed investment falls within a covered sector. According to the July 2007 draft of the Strategic Sectors Law, the review will occur within an interagency body representing a range of Russian government economic and security ministries, potentially headed by the Prime Minister's office. The interagency body may include

- the Federal Anti-Monopoly Service,
- the Ministry of Economic Development and Trade,
- the Ministry of Industry and Energy,
- the Ministry of Defense, and
- the Federal Security Service.

However, according to Russian government officials, the Russian government has not decided which government entity will receive applications for review. Further, according to the U.S. State Department, as of February 2008, the government had not reached agreement on which agency will lead the interagency group in reviewing investments, which has vital implications for the potential implementation of the proposed law. It is clear, however, that the February 2008 version of the draft reflects additional input from Russian security ministries, including the Federal Security Service.

Under the most recent version of the proposed Strategic Sectors Law, foreign companies seeking to obtain greater than 50 percent or a controlling stake, as defined by the law, in a Russian company will need to obtain Russian government approval if the target company is in a listed sector. These are

- pathogens;
- nuclear devices and radiation sources;
- coding/cryptographic equipment;
- explosives, weapons, and military machinery;
- aviation security and machinery (except civil aviation);
- any activities related to space;
- natural monopolies (e.g., oil and gas extraction); and
- metals and alloys having special properties.

The February 21, 2008, version of the Strategic Sectors Law adds four sectors to those that were included in the July 2007 draft. The additional sectors are

- telecommunications,
- radio,
- television, and
- fishing.

In addition, the February version of the Strategic Sectors Law further limits unsupervised foreign acquisition of Russian companies that own licenses to develop “strategic subsoil assets” to 10 percent, according to the U.S. State Department. Further, entities partly owned by foreign governments would be subject to a 5 percent limit on unsupervised ownership, according to the most recent draft. Foreign entities seeking a greater share of relevant Russian companies would need Russian government approval from a special commission.

The government approval includes both the mandatory anti-monopoly review and the national security review of the proposed investment. If a foreign investor does not seek a controlling stake, then only the standard FAS review is required. According to Russian government officials, the determination of what sector a proposed transaction falls within will be based on the acquired company’s government-issued business license. According to Russian government officials and lawyers experienced with foreign investment in Russia, the proposed Strategic Sectors Law, like the current FAS review process, identifies the specific documents and materials that must be submitted for the review to be completed. Under

the current FAS review process, the FAS can ask for supplemental documentation from the investor if it deems it necessary, which may delay the application process somewhat. However, according to the lawyers, this additional documentation is not normally difficult to provide or time-consuming.

According to Russian government officials, the proposed Strategic Sectors Law identifies specific criteria against which the proposed transaction will be judged by the interagency review body that is designated to determine whether a national security consideration merits denying an application. Decision criteria include, for example, whether the company to be invested in

- possesses state secrets,
- produces products subject to export controls,
- produces military goods, or
- deals with natural monopolies (e.g., oil, gas).

Under the proposed Strategic Sectors Law, the standard time frame for governmental review of foreign investment will be up to 90 days. In the event that the government determines that it needs additional time to complete its review, the initial 90-day review period can be extended by an additional 90 days, for a total of 180 days, or 6 months. According to the U.S. State Department, the Russian government has not decided whether the anti-monopoly review and the national security review will occur concurrently or consecutively. If held concurrently, the total review time frame would be 90 days, or 180 days in exceptional cases. If held consecutively, the total review time frame would expand to 120 days, or 210 days in exceptional cases.

If a proposed transaction meets the criteria for possible denial, but the threat to Russian national interests can be mitigated, then, according to a Russian government official, the deal will be approved if the investor accepts certain required conditions. The proposed Strategic Sectors Law provides for a range of possible mitigation conditions that may be enacted. These may include

- a commitment to protect state secrets, including potential access limitations for the investor;
- a commitment to continue deliveries of products, performance of work, and rendering of services under existing military contracts;
- a commitment to maintain the acquired firm's mobilization capacity;

- a commitment to work in accordance with tariffs subject to Russian Federation legislation on natural monopolies;
- a commitment to the fulfillment of business plans for further development;
- a commitment to measures to be taken aimed at preventing a threat to national security if martial law or a state of emergency is imposed; or
- a commitment to avoid staff layoffs for a designated period.

For example, according to a Russian government official, the Russian law on state secrets governs and limits who can lead an organizational unit of a company that possesses Russian state secrets. If a Russian company were purchased by a foreign entity, based on signed mitigation conditions, the unit within the company holding state secrets may be required to be run by Russian nationals with security clearances. According to a Russian government official, it has not yet been decided which Russian governmental entity will be responsible for ensuring that signed mitigation conditions are adhered to by the foreign investor.

The proposed Strategic Sectors Law provides for a judicial appeals process if the Russian government fails to issue a decision within 90 days or within the designated extended time frame.

The current 1999 Federal Law on Foreign Investment does not differentiate between foreign state-owned enterprises and others that seek to invest in Russia. According to Russian government officials, under the proposed Strategic Sectors Law, special rules will apply to foreign state-owned enterprises. Such entities will be barred from acquiring a controlling stake in Russian companies that are subject to the proposed Strategic Sectors Law, and in addition, foreign state-owned enterprises will have to seek Russian government approval to acquire a noncontrolling 25 to 49 percent stake in a Russian company.

While reviews of foreign investment fall under the provisions of the 1999 Federal Law on Foreign Investment as applied through the FAS anti-monopoly review process, the extraction of subsoil resources, for example, oil and natural gas, is subject to a range of requirements under the Russian Federation Law on Subsoil. The current standard has allowed foreign investment in certain projects above the 50 percent threshold. The Russian government is currently in the process of drafting amendments to

the Subsoil Law that would implement a number of changes.⁶² The July 2007 draft of the amendments allowed foreign investment in strategic subsoil resources up to 50 percent of the total stake in the given reserve. In addition, according to a Russian government official, under the proposed amendments, the required licenses for operations will only be given to domestic extractors. Foreign investors will have to enter into joint ventures with Russian oil and gas companies to invest in these areas.

Another important proposed change to the Subsoil Law would be the designation of certain reserves of subsoil resources (e.g., oil, natural gas, gold, and copper), that are larger than specified thresholds, to be “of federal significance” to the Russian Federation. The amendments would define “strategic field” as any oil field with extractable reserves of more than 70 million tons, gas fields with more than 50 billion cubic meters, and all offshore fields. Companies in which the Russian government is a majority owner would be exempt from limitations of foreign ownership.

Other Foreign Investment Laws and Policies

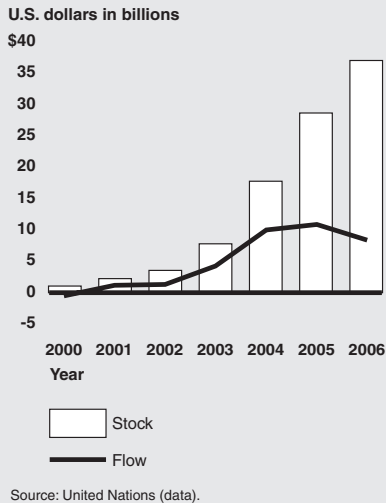
In addition to the 1999 Federal Law on Foreign Investment, other laws and policies in Russia affect foreign investment. For example, based on a Presidential Decree, certain Russian state-owned enterprises (SOE) and companies are not open to foreign investment. This listing of over 1,000 SOEs and companies that are off limits to foreign investment includes scientific, defense, and military factories and institutes; media companies; ports; airports; and shipping companies. According to a Russian government official, the Presidential Decree list and the companies in the sectors identified in the proposed Strategic Sectors Law may overlap.

⁶² According to Russian government officials, the Subsoil Law Amendments were originally to be included in the proposed Strategic Sectors Law. However, it was later determined that the Subsoil Law Amendments should be separated from the proposed Strategic Sectors Law.

In addition to the listing of specific SOEs and companies that are off limits to foreign investment, certain individual sectors within the Russian economy also have investment limitations. For example, according to a Russian government official, foreign investment in the aviation sector in Russia cannot currently exceed 50 percent control of the target company, and foreign investors must seek approval for obtaining a 25 to 50 percent stake.

Appendix XII: United Arab Emirates

Foreign investment in the United Arab Emirates
(stocks and flows 2000–2006)



- The United Arab Emirates (UAE) ranked 32nd in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- The UAE was the 50th largest recipient of FDI in the world in 2006.
- In 2006, FDI in the UAE totaled \$37.1 billion, an increase of more than \$36 billion over FDI stock in the UAE in 2000.
- FDI stock in the UAE as a proportion of GDP was 22 percent in 2006.

Background

The UAE is a loose federation of seven emirates, each with its own ruler. The UAE constitution established a government that includes a President, Vice President, Council of Ministers, Federal Supreme Council, and a 40-member Federal National Council. The Federal Supreme Council is the highest constitutional authority and is composed of the seven emirate rulers.

According to U.S. State Department officials, the UAE has one of the most open economies in the Middle East. In 2005, foreign investment in the UAE was approximately \$10 billion, accounting for nearly 34 percent of total foreign capital in the Arab world that year. Oil and natural gas production generated approximately 36 percent of the country's GDP in 2005. In addition, the UAE controls almost 10 percent of the world's oil reserves.⁶³ However, only 15 to 20 percent of the UAE's 4.4 million residents are UAE citizens. According to a UAE official, over 90 percent of private sector output comes from non-UAE residents.

According to U.S. officials and oil industry representatives, there are important relationship components to doing business in Arab cultures. For

⁶³ Most of these reserves are located in the Emirate of Abu Dhabi.

example, foreign investment and joint ventures in the UAE's oil and natural gas industries are based on decades-long relationships between the government of the UAE and western business partners.

Laws and Policies

According to U.S. and UAE officials, the Companies Law and the Agencies Law⁶⁴ represent the largest legal barriers to foreign direct investment in the UAE. The Companies Law states that foreigners and foreign companies are prohibited from owning more than 49 percent of a company established in the UAE. The Agencies Law states that foreign importers must operate through an agent to bring goods into the UAE. This agent must be either a UAE national or a company that is wholly owned by a UAE national.

According to U.S. and UAE officials, the Companies Law and the Agencies Law were implemented to ensure the country's economic growth would benefit its small citizen population by drawing UAE citizens into the workforce. However, according to a UAE official, since most private sector output comes from non-UAE citizens, these laws were particularly intended to draw UAE citizens from the government workforce into the private sector. Together, these efforts are sometimes referred to as the Emiratisation policy. According to a UAE official, these efforts reflect a constant tension between maintaining openness to the world and avoiding the social and political strife that can accompany efforts to modernize.

Related Restrictions to Foreign Investment

The Government Tenders Law and the Federal Industry Law also restrict foreign investment in the UAE. The Government Tenders Law states government suppliers and contractors must be UAE citizens or companies at least 51 percent owned by UAE citizens. In addition, according to an official from the Office of the U.S. Trade Representative, each emirate has its own rules on government procurement. The Federal Industry Law states that industrial projects must be 51 percent owned by UAE citizens, and that projects must be managed by a UAE citizen or have a board of directors that has a majority of UAE citizens.

⁶⁴ The Commercial Companies Law No. 8 of 1984 is commonly referred to as the "Companies Law." Federal Act No. 18 of 1981 Concerning Organizing Trade Agencies is commonly referred to as the "Agencies Law."

In addition to the above restrictions, the UAE limits foreign ownership of land, with rules varying from emirate to emirate. The UAE also has sector-by-sector limits on foreign ownership. Some sectors, like insurance, telecommunications, and travel agencies, are still mostly closed to foreigners. Traditionally, foreign investment in the UAE's oil and natural gas sectors has been limited to 40 percent, divided among several foreign joint venture partners. Emirate-level governments retain control of the other 60 percent, according to U.S. and oil industry officials.

Exceptions Exist to the UAE's Foreign Investment Restrictions

According to U.S. officials, the UAE has exceptions to the Agencies Law and the Companies Law, including 32 free trade zones (FTZ), which are special administrative areas governed by individual emirates, and country-specific exemptions. According to UAE officials, FTZs are not subject to any federal laws except criminal. Consequently, FTZs are exempt from the Companies, Agencies, Government Tenders, and Industry Laws. According to U.S. officials, FTZs usually have lower labor and tax requirements, and allow foreign companies to own 100 percent of an enterprise in any FTZ. This makes them attractive locations for foreigners to invest. However, according to U.S. officials, a foreign company invested in an FTZ that attempts to invest in non-FTZ areas would be subject to the UAE's foreign investment laws and regulations. According to one of these officials, this has created two separate and distinct economies in the UAE—the FTZ economy and the regular UAE economy.

According to U.S. officials, many of the barriers associated with foreign direct investment do not apply to citizens of other Gulf Cooperation Council countries, including Saudi Arabia, Qatar, Bahrain, Oman, and Kuwait. U.S. officials said the result is that the UAE has three levels of access for investors, whereby UAE nationals receive the most investment access, Gulf Cooperation Council nationals receive slightly less access, and non-Gulf Cooperation Council nationals receive the least access to investment opportunities in the UAE.

Practices

While the UAE does not have a formal foreign investment review process, according to U.S. and UAE officials, foreign investors are informally notified of sensitivities associated with attempted investments. According to a UAE official, some sectors, like military production, contain sensitive technologies and are clearly, if not explicitly, off limits to foreign investors. Moreover, other sectors, like oil and natural gas, contain sensitive technologies, but foreigners are allowed to invest in them. Further, since these prohibitions are not codified, if a foreigner attempts

to invest in an area deemed to be unacceptable, the investor will be privately redirected.

According to U.S. and UAE officials, this practice is informal for several reasons. First, the UAE's reputation for having an open business environment is very important to its economic success. Consequently, the UAE government is hesitant to say publicly that a given sector is closed. Second, since business deals in the UAE are based on personal relationships, the UAE government generally believes it is better to handle rejections quietly. Third, the UAE and individual emirates try to direct foreign investment into sectors where they see a development need. Fourth, since the UAE has only existed as a nation since 1971, its informal practices are not yet institutionalized.

The UAE has several national security concerns that, while not publicly stated, the government may consider when assessing foreign investment. For example, according to U.S. officials, the UAE treats oil and natural gas production as a national security issue since these industries represent a major portion of the country's GDP. U.S. officials told us that, as a consequence, the UAE government strictly controls investment in those areas, although restrictions are not made public. The UAE's labor market is another unstated national security concern, since the vast majority of private sector workers are foreigners. Water and power generation are considered strategic as well.

New Developments

According to U.S. and UAE officials, the UAE is in the process of relaxing its investment laws. However, according to U.S. officials, this is difficult due to opposition from Emirati citizens who benefit from the current laws. According to U.S. and UAE officials, current laws limiting foreign investment in the UAE are incongruent with the UAE's efforts to attract foreign investment. However, according to the U.S. State Department, the UAE's current laws have created interest groups in the UAE that depend on the benefits these rules provide. U.S. officials told us that opening investment outside the FTZs involves overcoming entrenched opposition from local constituencies, particularly those with agency agreements, making further liberalization of investment policies a slow process.

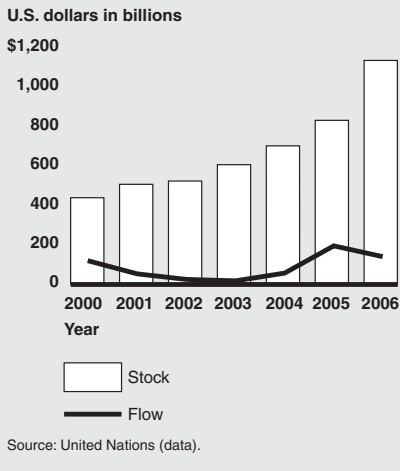
According to U.S. and UAE officials, the UAE government plans to liberalize the Companies Law and the Agencies Law. For example, according to UAE officials, the UAE has modified the Agencies Law to allow companies to break contracts with nonperforming agents. These officials told us that companies can now petition the Ministry of the

Economy to dissolve such contracts. However, according to a U.S. official, while foreign companies technically have legal recourse, in reality the process of dissolving a contract with a nonperforming agent is still extremely difficult.

According to a UAE official, the central government intends eventually to dissolve the Companies Law and the Agencies Law. However, this probably will happen in stages. According to the same official, the current 49 percent cap on foreign ownership in the Companies Law likely will be raised to 75 percent, and then 100 percent. Moreover, this liberalization probably will happen on a sector-by-sector basis.

Appendix XIII: United Kingdom

Foreign investment in the United Kingdom
(stocks and flows 2000–2006)



- The United Kingdom (UK) ranked second in terms of the average value of FDI inflows worldwide between 2000 and 2006.
- In 2006, FDI stock in the UK totaled \$1,135 billion, an increase of \$696.6 billion over FDI stock in 2000.
- FDI stock in the UK as a proportion of GDP was 47.8 percent in 2006.

Background

The UK has historically maintained a liberal investment policy with an economy based on trade and is the second largest single recipient of inbound foreign investment in the world. The UK generally makes no policy distinction between domestic and foreign investment. The primary exception is for investments affecting national security. More than 25 percent of businesses located in London are currently under foreign ownership.

Foreign Investment Laws and Policies

The UK has no legal framework specifically designed to monitor foreign direct investment for national security reasons. However, the government has the authority under multiple laws to block specific transactions that are determined to be against the national interests of the United Kingdom. Since the UK is subject to European Union law, the European Union Merger Regulation, established in 1990, has shaped its policy on foreign investment because the regulation details the criteria under which a government can intervene in mergers and acquisitions. The Industry Act of 1975 provides the British government with the authority to intervene when the takeover of important manufacturing concerns by nonresidents is

against the national interest.⁶⁵ However, the British government has never used the authority provided under this act. The Enterprise Act of 2002 provides the government the authority to intervene to block or place conditions on the approval of mergers and acquisitions involving British companies if the transaction is considered to be against the public interest. The authority under the act has been designated to the Secretary of State for the Department of Business, Enterprise, and Regulatory Reform (DBERR— previously the Department of Trade and Industry).⁶⁶ The Enterprise Act overhauled the framework for regulating mergers in the UK, updating the Fair Trading Act of 1973.

According to British government officials, the Enterprise Act is primarily intended as a review of competition or anti-trust concerns associated with mergers. However, the law allows for a “special intervention” when the Secretary of State determines that a transaction may harm the public interest. This allows the government to intervene if a foreign investment poses a threat to public security.⁶⁷ The act, as amended, specifies that foreign investment involving national security, the media, or water is subject to a public interest intervention by the Secretary of State. The Enterprise Act provides specified considerations that are relevant to the United Kingdom’s national security. However, the Secretary of State has broad authority to intervene due to considerations that, while not specified by the law, “in the opinion of the Secretary of State, ought to be so specified.” Similarly, the Secretary of State has the authority to issue an order that effectively modifies the relevant section of the Enterprise Act so that considerations that have not been specified are effectively added to the law. The Enterprise Act also specifies that the Secretary of State has the authority to intervene in mergers involving a UK government contractor that possesses information “relating to defense and of a confidential nature.”

⁶⁵ The law does not define the term “important.” However, manufacturing industries are defined under the Standard Industrial Classification Orders and include defense-related sectors such as ordnance and aerospace equipment manufacturing.

⁶⁶ The Department of Business, Enterprise, and Regulatory Reform is charged with recommending intervention on the basis of public interest when necessary. If intervention is recommended, the UK Secretary of State at DBERR issues a special intervention and refers the matter to the Office of Fair Trading and the Competition Commission for further review.

⁶⁷ The authority can be invoked regardless of the domicile of the involved parties; hence, a transaction could involve only British nationals.

Transactions in which (1) sales exceed £17 million annually or (2) the relevant market share exceeds 25 percent may require a review by the British Office of Fair Trading. Additionally, the UK may intervene in a foreign investment of any size in the areas of national security or the media if the government deems it is in the public interest to do so and the Secretary of State issues a special intervention.

Since the Enterprise Act merger provisions came into effect in 2003, the Secretary of State has issued an intervention notice six times on national security grounds; only one of these notices was issued when there was not also an accompanying anti-monopoly review. All six of these cases involve the protection of sensitive information associated with military programs. The Secretary of State approved each proposed transaction under the condition that the acquiring company accepts a series of undertakings to mitigate the security risk associated with the investment. According to business representatives familiar with the intervention and review process, one of the companies eventually did not complete the proposed approved deal. A seventh public interest intervention was initiated because of a merger in the media field. The Secretary of State issued an intervention notice for the acquisition of a minority share in a television broadcasting company in February 2007. The case was reviewed by the Competition Commission, one of the reviewing bodies under the Enterprise Act. The Competition Commission made recommendations to the Secretary of State, and in January 2008, the Secretary made an adverse public interest finding in the case and will require a partial divestment of shares.

Related Restrictions to Foreign Investment

The British government restricts foreign investment in specific companies that it considers important to the national security of the UK. Through government ownership of a golden share established in the articles of association of each company, the UK has various rights related to citizenship requirements for the companies' boards of directors, control over the percentages of foreign-owned shares, or approval requirements for the dissolution or disposal of any strategic assets. This share does not give the government control over the companies' routine business activities, investment decisions, or appointments. The use of golden shares faced a number of adverse decisions from the European Court of Justice in 2002 and 2003, which ruled that the use of golden shares is acceptable only in specific circumstances and with strict conditions. However, the UK continues to use golden shares on the grounds of national security, and does not intend to dispose of these shares in certain strategic areas.

Some prominent company specific limitations established in golden shares include the following:

- BAE Systems limits foreign ownership of voting stocks to 15 percent.
- Rolls-Royce limits foreign ownership of voting stocks to 15 percent. The British government's consent is required for the disposal of the company's nuclear business or the group as a whole.
- British Energy requires the consent of the government to allow a purchase of more than 15 percent of its issued shares.
- Other companies in which the government holds a golden share are Rosyth Royal Dockyard Limited, Davenport Royal Dockyard Limited, BAES (Marine) Limited, the Atomic Weapons Establishment, and QinetiQ. Each company's articles of association grant the government various rights, including the ability to impose certain restrictions and oversee major company decisions.

Review Process

Government reviews of foreign investment are conducted by the Office of Fair Trading (OFT). If the OFT determines that there is potential for anti-competitive consequences from the transaction, it refers the transaction to the Competition Commission for further review. The Competition Commission may consult with the parties to the transaction and normally issues decisions in 30 days, although it is allowed 6 months to complete the review. The Competition Commission can negotiate undertakings with the investor as conditions for approval of the transaction. Once a transaction is approved, the decision is final. It cannot be reopened, modified, or reversed.

Prior to an official review, companies generally meet informally with the relevant agency to discuss the potential transaction. For example, the parties to a proposed transaction in the defense sector would normally consult in advance with the UK Ministry of Defense and negotiate acceptable undertakings so that Secretary of State would not need to issue a notice of intervention. During the informal review process, the relevant government offices consult with the investor and agree on undertakings. According to a lawyer familiar with the UK review process, the formal process primarily serves to provide a public comment period for the decisions that have already been made as part of the informal process. There is no requirement to notify the government of an investment before a transaction is completed. The government has 4 months after a transaction is completed to decide if it is necessary to intervene.

New Developments

According to British government officials, no changes are currently being considered to the United Kingdom's policies regarding foreign investment. It is possible that changes or additions to European Union policies in this area could affect the United Kingdom. In 2006, the potential takeover of a major oil company in the United Kingdom by a foreign state-owned oil company caused public controversy. However, British government officials discussed the potential transaction and decided that despite the possible threat to the United Kingdom's energy supply, the British government would not intervene in the transaction on public security grounds.

The United Kingdom's Chancellor of the Exchequer outlined British policy toward sovereign wealth funds investing in the United Kingdom in his first speech as Chancellor. He stated that the United Kingdom welcomes foreign investment, including that of state-owned enterprises. To exemplify this openness, British government officials pointed out that all of the United Kingdom's ports are owned by Dubai Ports World.

Appendix XIV: GAO Contact and Staff Acknowledgments

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