ACCOUNTABILITY FOR SECURITY-RELATED INVESTMENT POLICIES

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I. Introduction

OECD work on Freedom of Investment (FOI) has identified four key principles – non-discrimination, transparency, proportionality and accountability – for evaluating restrictive foreign investment policy measures that seek to safeguard essential security interests and public order. Participants in the FOI project have already had in-depth discussions of transparency and proportionality and have formulated more specific recommendations for these two principles. The current note looks in more detail at accountability in the context of security-related investment policies as background for discussions at FOI Roundtable VIII and to support completion of the accountability section in the guidance provided in the April 2008 reports by the OECD Investment Committee.[1] The guidance on restrictive investment measures contained in these reports is reproduced in Annex 1.

Accountability underpins all OECD work on regulatory quality and governance. An OECD report entitled "Public Sector Transparency and Accountability"[2] defines accountability as meaning "that it is possible to identify and hold public officials to account for their actions." This document draws on previous discussions under the FOI project, including country submissions on accountability reproduced in Annex 2.

The remainder of the note is organised in the following sections:

- Section II. Earlier discussions of transparency – implications for accountability
- Section III. To whom are investment policy makers accountable? – Citizens and the international community
- Section IV. Who is accountable? Political level officials and civil servants
- Section V. Accountability mechanisms – administrative; legal and political.

Section V asks delegates to review a draft set of recommendations for accountability practices that would complete the set of recommendations proposed in Box 2 of the two OECD Investment Committee reports completed in April 2008.

II. Earlier FOI discussions on transparency – Implications for accountability

Policy transparency is the first step in assuring accountability of public policy. At the December 2007 FOI Roundtable, participants exchanged information and views about transparency in the context of security-related investment policies. The discussions showed that, at one level, the participating countries had similar practices: most codify investment laws, make them available in centralised registers and publish them on the internet. While providing as much information as possible to concerned parties, most countries also take measures to safeguard commercially sensitive information (including, at times, the fact that a review is taking place) and to protect security-related information. Early discussions at the FOI Roundtables showed that finding an appropriate balance between protecting sensitive or classified

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1 These reports are: Progress Report on the "Freedom of Investment, National Security and 'Strategic' Sectors" project (http://www.oecd.org/dataoecd/1/58/40473798.pdf) and the Report on "Sovereign Wealth Funds and Recipient Country Policies" (http://www.oecd.org/dataoecd/34/9/40408735.pdf)

2 "Public Sector Transparency and Accountability: Making it Happen" OECD (2002) page 7.

information and remaining transparent to political or civil oversight is one of the key challenges facing investment policy makers in recipient countries.

In other areas, however, transparency policies are less developed. As shown in the Table below (updated from the published summary of the transparency report), few countries systematically provide information about the outcomes of their security-related investment policies. Some countries issue press releases when investment proposals are blocked, but few engage in systematic reporting on the review processes, nor do many publish regulatory impact assessments or other analyses of policy outcomes.

Table. Procedural transparency and predictability – Ex-post disclosure/reporting

Country	Public announcement of outcome (e.g. press release)	Other *ex post* reporting mechanisms		Notes
		Reports to Parliament or legislative bodies	Annual report?	
Australia			Yes	The annual report provides general information (investors are not named) on the number of approval applications received, number of enquiries handled, numerical characterisation of decisions taken and of time taken to process applications.
France				
Germany				
Korea	Public announcement of any decision to restrict investments			
Japan	Public announcement of decisions to restrict investments			
Latvia				
Mexico				
Poland				
Romania				
Russian Federation				
Spain				
United States	Yes, if President decides to prohibit an investment.	Yes	Yes	Under a law enacted in July 2007, CFIUS process is required to include a detailed discussion in an annual report from CFIUS to Congress on the perceived adverse effects on critical infrastructure resulting from foreign acquisitions. CFIUS is also required to: 1) publish guidance in the *Federal Register* on the types of transactions that it has reviewed and that have presented national security considerations; and 2) to notify Congress after each review and investigation.

III. To whom are investment policy makers accountable? – Citizens and the international community

All public policy makers are ultimately accountable to the citizens on behalf of whom public policies are enacted. This is the most fundamental principle of democratic governance. The institutions of public sector accountability – that is, the institutions of administrative, political and judicial accountability that are discussed below – help to make this principle a reality. Accountability to citizens and the institutional mechanisms that support it are as relevant for security-related investment policies as for other aspects of public policy.

For foreign investment policies, another layer of accountability – accountability to the international community – is added to accountability to citizens. Accountability at the international level is created by international agreements of various sorts (for example, the OECD investment instruments and associated OECD Council Decisions on their implementation). Through these agreements, governments recognise their shared interest in maintaining an international investment system that provides open and competitive market access while also being widely viewed as fair and legitimate. Because they acknowledge these shared interests, governments have agreed to design their investment policies in conformity with internationally-agreed principles (e.g. non-discrimination and transparency) and have created accountability mechanisms (e.g. notification requirements under the OECD investment instruments) through which they agree to explain their policy actions to one another. While acknowledging each national government's sovereign authority to set policy in its territory, international investment agreements provide what are often useful constraints on national political outcomes.

IV. Who is accountable? – Political level officials and civil servants

Two groups of public officials need to be made accountable for investment policies seeking to safeguard essential security interests and public order: 1) political level government officials (e.g. heads of state or ministers) who have executive responsibilities for security-related investment policy; and 2) the civil servants who are involved in the day-to-day implementation of these policies.

Political-level officials. Political-level public officials straddle the executive and political functions of government. Decisions to block or otherwise restrict foreign investments merit high level political involvement and accountability for two reasons. The first is the gravity of the decision itself – the decision to restrict a foreign investment proposal impedes the full expression of property rights, which are an essential underpinning of market economies. Second, if they are to be effective, the decision processes used to make such decisions will normally involve several parts of government (e.g. foreign affairs, economics, sectoral regulation, intelligence, defence and law enforcement) and therefore will require intra-governmental co-ordination. Ensuring that such co-ordination is effective is a central role of the top executive function.

Civil servants. The civil servants who implement investment policies on a day-to-day basis also contribute in important ways to the quality of these policies' outcomes. The issues raised by security-related investment policies are multi-faceted and require careful analysis and thought. There is a need to work effectively with other government bodies in order to ensure that all relevant information and perspectives are brought to bear on the problem. Furthermore, because the economic stakes behind such decisions are high, there is also a possibility that civil servants (as well as high level officials) might be subject to attempts by domestic or foreign actors to influence the outcome of the process in an inappropriate manner.

As discussed in the next section, on mechanisms of accountability, political-level government actors and civil servants need to have adequate resources and to be surrounded by appropriate incentives and controls. Countries use a variety of political, administrative and judicial mechanisms to ensure that political level officials and civil servants are accountable to other political institutions and to the citizens they are supposed to serve. These are discussed in the next section.

V. Mechanisms of accountability

Different countries have different mechanisms for ensuring that their foreign investment regulations achieve their objectives.

Governments use three broad mechanisms to enhance accountability. First, administrative accountability – basically via public sector management systems – comes through controls and incentives that allow the political officials that are the top executives of the government to exercise managerial control over the implementation of agreed policies by the government. These include such tools as hierarchical controls, internal information and reporting systems and promotion and disciplinary procedures. Second, political oversight stems from systemic monitoring by parliamentary bodies. Third, there can be judicial oversight or other appeals mechanisms – that is, the possibility of contesting individual decisions and procedures through judicial or administrative channels. Finally, as noted above, international agreements of various types can create accountability mechanisms (through multilateral co-operation or through arbitral proceedings).

The exact way that these accountability mechanisms impinge on particular investment policy measures depends *inter alia* on the type of measure. For example, some countries seek to safeguard national security by, in effect, prohibiting foreign investments in certain sectors. Insofar as the closed sectors are established by legislation the only oversight that is needed relates to whether the regulation is actually enforced. And, the only contestation that is likely relates to whether or not a targeted company can truly be considered as operating in one of the closed sectors. More complex oversight considerations arise when authorities rely on investment review procedures that involve a degree of administrative discretion. Oversight might then involve addressing the more difficult question of whether such discretion has been used appropriately in a particular case.

a) Administrative and political mechanisms

Administrative and political accountability operate through generic systems of political decision making and public sector management. The institutions of political oversight take various forms, according to various national arrangements. For example, monitoring by parliament or other institutions with legislative functions[3] includes direct monitoring, the consideration of regular reports from the regulatory bodies or, in some countries, the possibility of expressing no confidence in the executive. Public sector management systems involve various controls and incentives that help ensure that public officials at all levels are diligent in carrying out their duties as intended by law and are free from corruption, undue influence and conflict of interest. These systems have been extensively reviewed in other OECD fora[4] and they influence the conduct of security related investment policy as well that of most other policies.

An important challenge for investment policy oversight is to ensure that such oversight is exerted in a manner that does not jeopardise the integrity and objectivity of review procedures – governments will wish to both assure the political accountability of policy implementation required for democratic governance

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3 See Hironori Yamamoto, *Tools for Parliamentary Oversight: A Comparative Study of 88 National Parliaments.* Published by the Inter-parliamentary Union in partnership with the World Bank Institute.

4 See, for example, "Public Sector Transparency and Accountability: Making it Happen," OECD, 2002.

while avoiding overbearing political interference in this implementation. The legislative powers are well advised not to try to affect the outcomes of individual cases arising from applications of the legislation. By infringing on the autonomy of regulatory bodies they could put at risk the integrity and effectiveness of these regulatory procedures. Peer review and other international accountability mechanisms may help to constrain excessive political involvement in the process of implementing security-related investment policies.

b) Recourse for investors –contesting decisions through administrative or judicial procedures

The degree to which individual awards and procedures can be contested in courts or through administrative appeals mechanisms varies across countries. Some countries (e.g. Argentina, China, France, Germany, Korea, Lithuania and the United Kingdom) do allow rejected foreign investors to contest the security-related investment policy decisions in various ways.[5]

A separate issue relates to regulatory decisions made on the basis of classified information. The need to safeguard national security may, in this case, militate toward either avoiding legal contestation altogether, curtailing the plaintiff's right to subpoena and examine crucial evidence, or applying specific court procedures – or specialised courts – designed to safeguard the confidentiality of sensitive government information. Similarly, the concerns that motivated a measure may also necessitate withholding information from the investor; thus making legal recourse difficult or impracticable. In addition, some national constitutions, by allocating authority with respect to national security, may place limits on the scope of authority of the courts.

Some countries allow investors to contest regulatory decisions on procedural grounds. According to legal traditions such proceedings may be brought before administrative tribunals or arbitrational courts, or (for instance in the common-law system) they may be made subject to judicial review by the regular court system. Contestation on this basis normally focuses on an allegation of an abuse of process or of irregularities. The coverage of the reviews by the judicial or arbitrational instance differs across countries, as does the extent of possible remedies, but in most cases a victory for the plaintiffs will lead to a renewed regulatory review rather than a reversal of the decisions.

In most of the countries applying screening or authorisation procedures – and regardless of the opportunities for legal redress – disagreements between the authorities and would-be investors are mostly settled in the course of the review process itself. Insofar as authorities signal to investors that their proposals is unlikely to meet with approval, investors face strong incentives to either submit a revised proposal aimed at accommodating the regulatory concerns or withdraw from the process. Only in cases where investors feel that the "regulatory concerns" expressed run counter to applicable law or international treaty obligations do they have an interest in pursuing a process of eventual rejection and judicial review.

Finally, as documented in a 2006 review of investment treaties, foreign investors can challenge government measures taken on national security grounds before international arbitration. However, the

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[5] Information provided in 2006 indicates the following policies about the scope for investors to contest investment policy decisions: In Argentina, foreign investors are guaranteed full access to Argentine courts and administrative proceedings in order to file any complaints. In Korea, investors may file administrative suits. China provides for various dispute resolutions mechanisms, including negotiation, mediation, administrative review, arbitration and litigations. Disputes between the foreign investor/investors and the Republic of Lithuania relating to infringement of their rights and lawful interests (investment disputes) can be considered upon agreement between the parties by the courts of Lithuania, international arbitration bodies or other institutions. In the United Kingdom (where controls on foreign investments are found mainly in competition policy), any "action to prevent or add conditions to a merger is open to legal challenge." The new Russian law on strategic sectors also allows for appeals of review decisions.

background paper entitled "Essential security interests under international investment law"[6] notes that, in this area, "jurisprudence is scarce."

One drawback of both litigation and arbitration in international tribunals is that they can be very costly for all parties (foreign investors and host governments) and can lead to acrimonious relations between foreign investors and host societies. For these reasons, litigation and international arbitration should be thought of as "last resort" accountability mechanisms. It is important that other mechanisms ensure that security-related investment policy decisions are, on average of high quality, so that recourse to these mechanisms is rare.

[6] See http://www.oecd.org/dataoecd/59/50/40243411.pdf .

Box 2. Accountability recommendations

Accountability – procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels should be considered to ensure accountability of the implementing authorities.

- *Accountability to citizens*. Authorities responsible for restrictive investment policy measures should be accountable to the citizens on whose behalf these measures are taken. Countries use a mix of political and judicial oversight mechanisms to preserve the neutrality and objectivity of the investment review process while also assuring its political accountability. Measures to enhance the accountability of implementing authorities to Parliament should be considered (e.g. Parliamentary committee monitoring of policy implementation and answers or reports to Parliament that also protect sensitive commercial or security-related information).

- *International accountability mechanisms*. All countries share a collective interest in maintaining international investment policies that are open, legitimate and fair. Through various international standards, governments recognise this collective interest and agree to participate in related international accountability mechanisms (e.g. the OECD notification and peer review obligations in relation to restrictive investment policies). In particular, these help constrain domestic political pressures for restrictive and discriminatory policies. Recipient governments should participate in and support these mechanisms.

- *Recourse for foreign investors.* The possibility for foreign investors to seek review of decisions to restrict foreign investments through administrative procedures or before judicial or administrative courts can enhance accountability. However, some national constitutions' allocation of authority with respect to national security may place limits on the scope of authority of the courts. Moreover, judicial and administrative procedures can be costly and time-consuming for both recipient governments and investors, it is important to have mechanisms in place to ensure the effectiveness, integrity and objectivity of decisions so that recourse to such procedures is rare. The possibility of seeking redress should not hinder the executive branch in fulfilling its responsibility to protect national security.

- *The ultimate authority for important decisions (e,g, to block foreign investments) should reside at a high political level.* Such decisions require high-level involvement because they may restrict the free expression of property rights, a critical underpinning of market economies, and because they often require co-ordination among numerous government functions. The final decision to prohibit (or block) an investment should be taken at the level of heads of state or ministers.

- *Effective public sector management*. Broader public sector management systems help ensure that the political level officials and civil servants responsible for security-related investment policies face appropriate incentives and controls for ensuring that they exercise due care in carrying out their responsibilities and are free from corruption, undue influence and conflict of interest.

ANNEX. INVESTMENT POLICY GUIDANCE FROM THE 'FREEDOM OF INVESTMENT' PROJECT

Recommendations contained in the April 2008 reports by the Investment Committee

Participants have agreed on the following guidance for investment policy measures designed to safeguard national security:

Non-discrimination – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.

Transparency/predictability – while it is in investors' and governments' interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.

- *Codification and publication*. Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register; on internet). In particular, evaluation criteria used in reviews should be made available to the public.

- *Prior notification*. Governments should take steps to notify interested parties about plans to change investment policies.

- *Consultation*. Governments should seek the views of interested parties when they are considering changing investment policies.

- *Procedural fairness and predictability*. Strict time limits should be applied to review procedures for foreign in-vestments. Commercially-sensitive information provided by the investor should be protected. Where possible, rules providing for approval of transactions if action is not taken to restrict or condition a transaction within a specified time frame should be considered.

- *Disclosure of investment policy actions* is the first step in assuring accountability. Governments should ensure that they adequately disclose investment policy actions (e.g. through press releases, annual reports or reports to Parliament), while also protecting commercially-sensitive and classified information.

Regulatory proportionality – Restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.

- *Essential security concerns are self-judging*. OECD investment instruments recognize that each country has a right to determine what is necessary to protect its national security. This determination should be made using risk assessment techniques that are rigorous and that reflect the country's circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear.

- *Narrow focus.* Investment restrictions should be narrowly focused on concerns related to national security.

- *Appropriate expertise*. Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions.

- *Tailored responses*. If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals. This would include providing for policy measures (*especially* risk mitigation agreements) that address security concerns, but fall short of blocking investments.

- *Last resort.* Restrictive investment measures should be used, if at all, as a last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

Accountability – procedures for parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that decisions to block an investment should be taken at high government levels should be considered to ensure accountability of the *implementing* authorities. Discussions of accountability under the "Freedom of Investment" project will take place in late 2008.