We must guard against growing protectionism

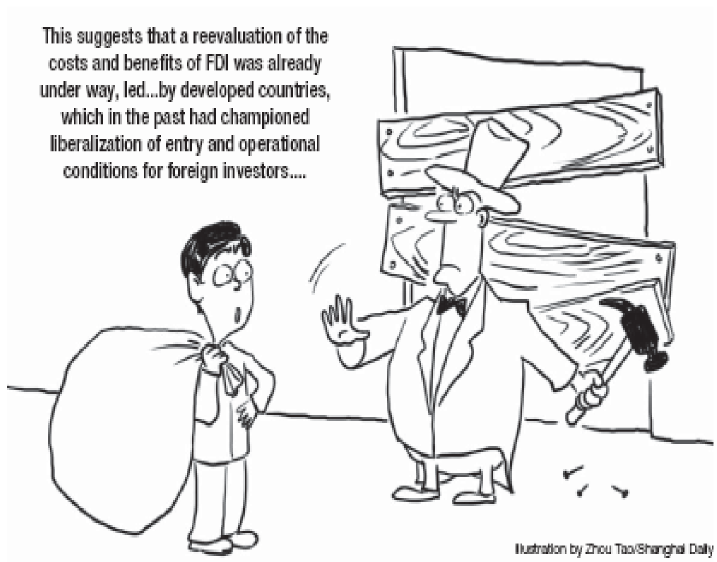

Illustration by Zhou Tao/Shanghai Daily

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DURING its most recent meetings, the G8 took a strong stance against protectionist measures in the area of foreign direct investment (FDI), echoing calls for a moratorium in such measures issued earlier by the G20. Both were right to do so.

According to the United Nations Conference on Trade and Development, only 6 percent of all the changes in national FDI regulations around the world between 1992-2002 were in the direction of making the investment climate less welcoming.

That figure doubled to 12 percent of all regulatory changes in 2003-2004, and almost doubled again, to 21 percent of all FDI regulatory changes, in 2005-2007.

In Latin America, for example, some 60 percent of all FDI regulatory changes in 2007 were unfavorable to foreign investors.

Overall, countries that had implemented at least one regulatory change that made the investment framework less welcoming in 2006-2007 accounted for some 40 percent of world FDI inflows during that period — an impressive figure that demonstrates that something very dubious is afoot.

And these data refer to formal changes in laws and regulations; no data are available on the extent to which unchanged laws and regulations are implemented in a more restrictive manner, increasing informal barriers to the entry and operations of foreign firms.

Of course, not every measure that makes the climate less welcoming for foreign direct investors is protectionist. Basically, there are two situations that should qualify.

In the case of inward FDI, protectionism involves new official measures that are used to prevent or discourage investors from coming to or staying in a host country.

For outward FDI, protectionism involves measures that require domestic companies to repatriate assets or operations to the home country, or that discourage certain types of new investments abroad.

But the definition of FDI protectionism can become more complicated, because measures taken in the interest of legitimate public policy objectives — for example, protecting national security or increasing FDI's contribution to the host economy — are not necessarily instances of it, even if they make the foreign-investment climate less hospitable.

Nevertheless, even with this caveat, there has been a rise of FDI protectionism that predates the current financial crisis and recession.

This suggests that a reevaluation of the costs and benefits of FDI was already under way, led, interestingly enough, by developed countries, which in the past had championed liberalization of entry and operational conditions for foreign investors and their protection under international law.

For some countries, like the United States, this reevaluation is grounded in national security concerns (largely undefined) that arose in the aftermath of the terrorist attacks of September 11, 2001.

But there also seems to be a bit of a reaction against the "new kids on the block," namely multinational enterprises from emerging markets, especially when these are state-owned and seek to enter the US market through mergers and acquisitions.

Hence the strengthening of the active screening mechanism of the Committee on Foreign Investment in the US.

In the case of some other developed countries (for example, Canada, France and Germany), national security concerns extend to economic considerations and the protection of "national champions."

In some of these cases, legitimate public-policy objectives may well be involved. But the boundary line between such objectives and protectionism can be a very fine one.

The financial crisis and recession may dampen the rise of FDI protectionism, as countries seek capital to shore up local firms and increase investment to help them promote economic recovery.

But the global downturn may also accentuate protectionism, especially if nationalistic impulses gain the upper hand, perhaps stimulated by fire-sales of domestic assets (as we saw during the Asian financial crisis). The bottom line is that the investment climate for foreign direct investors is becoming less welcoming. While this is certainly not the dominant approach toward FDI, we need to be vigilant that it does not become so.

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