REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION DETERMINATIONS

VOLUME ONE

Edited by

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INTRODUCTION: POLITICAL RISK

The Rise of Foreign Direct Investment

The increase in foreign direct investment (FDI) over the past three decades has been remarkable. Since 1980–1985, when global FDI inflows averaged roughly US$50 billion per year, these flows have grown by a factor of forty, to US$2 trillion in 2007, although they declined to $1.7 trillion in 2008 and (as will be discussed below) declined even further in 2009 (figure 1). Globally, the number of multinational enterprises (MNEs)—firms headquartered in one country and controlling assets in another country—rose to more than 82,000 (of which some 21,000 were headquartered in developing countries) in 2008, with more than 810,000 foreign affiliates spread all over the world. By the end of 2008, world FDI flows had accumulated to a stock of over US$15 trillion, generating sales by foreign affiliates estimated to be worth some US$30 trillion (table 1); this sales value was about one and a half times the value of world exports the same year (US$20 trillion).

As a result of these developments, FDI has become an even more important vehicle to bring goods and services to foreign markets. Moreover, approximately one third of world trade consists of 'intra-firm trade', ie trade among the various units (foreign affiliates, headquarters) that makes up the increasingly integrated international production systems of individual MNEs. In this manner, MNEs integrate on a regional or global scale not only markets but also national production systems. The bulk of the world's commercial research and development is

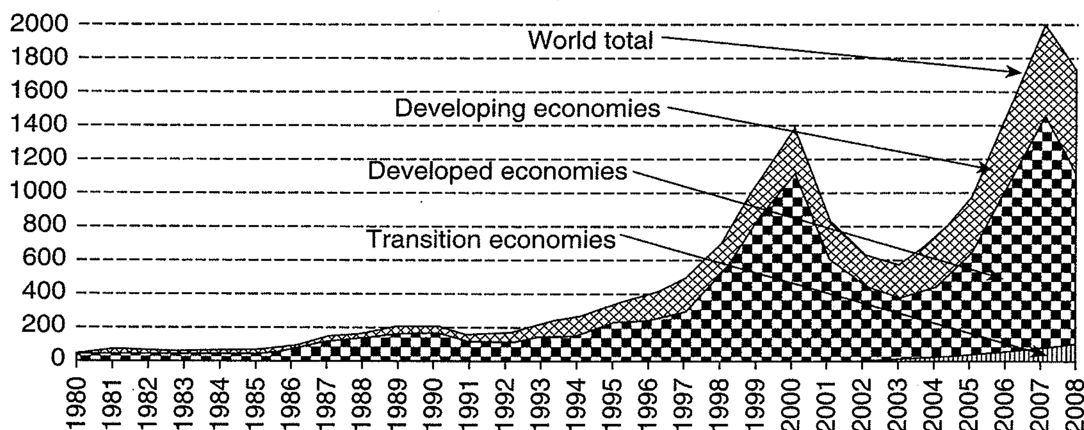

Figure 1 FDI inflows, global and by group of economies, 1980–2008 (Billions of US dollars)

Source: UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 4.

Table 1 Selected indicators of FDI and international production, 1982–2008

Item	Value at current prices (Billions of Dollars)				Annual growth rate (Percent)							
	1982	1990	2007	2008	1986–1990	1991–1995	1996–2000	2004	2005	2006	2007	2008
FDI inflows	58	207	1979	1697	23.6	22.1	39.4	30.0	32.4	50.1	35.4	–14.2
FDI outflows	27	239	2147	1858	25.9	16.5	35.6	65.0	–5.4	58.9	53.7	–13.5
FDI inward stock	790	1942	15660	14909	15.1	8.6	16.0	17.7	4.6	23.4	26.2	–4.8
FDI outward stock	579	1786	16227	16206	18.1	10.6	16.9	16.8	5.1	22.2	25.3	–0.1
Income on inward FDI	44	74	1182	1171	10.2	35.3	13.3	33.4	32.8	23.3	21.9	–0.9
Income Outward FDI	46	120	1252	1273	18.7	20.2	10.3	42.3	28.4	18.4	18.5	1.7
Cross-border M&As*	..	112	1031	673	32.0[h]	15.7	62.9	28.4	91.1	38.1	62.1	–34.7
Sales of foreign affiliates	2530	6026	31764[c]	30311[c]	19.7	8.8	8.1	26.5	5.4[c]	18.9[c]	23.6[c]	–4.6[c]
Gross products of foreign affiliates	623	1477	6295[d]	6020[d]	17.4	6.8	6.9	13.4	12.9[d]	21.0[d]	20.1[d]	–4.4[d]
Total assets of foreign affiliates	2036	5938	73457[e]	69771[e]	18.1	13.7	18.9	4.8	20.5[e]	23.9[e]	20.8[e]	–5.0[e]
Exports of foreign affiliates	634	1496	5775[f]	6664[f]	22.2	8.6	3.6	21.3	13.8[f]	15.0[f]	16.3[f]	15.4[f]
Employment by foreign affiliates (thousands)	19864	24476	80396[g]	77386[g]	5.5	5.5	9.7	12.2	8.5[g]	11.4[g]	25.4[g]	–3.7[g]
GDP (in current prices)	11963	22121	55114	60780[h]	9.5	5.9	1.3	12.6	8.4	8.2	12.5	10.3
Gross fixed capital formation	2795	5099	12399	13824	10.0	5.4	1.1	15.4	11.8	10.9	13.8	11.5
Royalities and licence fee receipts	9	29	163	177	21.1	14.6	8.1	23.7	10.6	9.1	16.1	8.6
Exports of goods and non-factor services	2395	4414	17321	19990	11.6	7.9	3.7	21.3	13.8	15.0	16.3	15.4

Source: UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 18.

being undertaken within these corporate systems. More generally, through positive spillovers and backward linkages, FDI is an important means by which host countries acquire bundles of tangible and intangible assets, including capital, employment, technological know-how, new management techniques, skills, and access to markets.[1] All of these assets associated with FDI are central to economic growth and development.

Although there has been a notable growth in recent years of outward FDI (OFDI) from emerging market MNEs, developed countries are still the overwhelming source for such investment. OFDI flows from developed economies reached a record high of US$1.8 trillion in 2007 (table 2), representing roughly 84 percent of total OFDI flows that year.[2] OFDI flows from developing countries were US$285 billion in 2007, largely accounted for by OFDI from South, East and South-East Asia (US$175bn in 2007) and Latin America and the Caribbean (US$52bn). Such investment from developing countries amounted to roughly 13 percent of world flows (10–11% between 1995 and 2000). Firms from economies in transition invested approximately as much abroad as those from Latin America and the Caribbean, namely US$52bn. The services sector accounts for the greatest share of both global OFDI stock (65% in 2007) and global OFDI flows (58% in 2007), followed by manufacturing, although there has been a recent increase in OFDI flows to the primary sector, especially to the extractive industry sector.[3]

In 2008, the increase in FDI flows came to a temporary halt with the financial crisis and the global economic downturn. Flows declined (though remained positive), principally due to a reduction of demand and the reduced ability of firms to finance their overseas expansion, be it through mergers and acquisitions (the principal mode of entering foreign markets) or greenfield investment.[4] Global FDI outflows declined by 13 percent, though the decline was largely due to reduced OFDI from developed countries (–17% from 2007), whereas OFDI from developing and transition economies as a group actually increased by 4 percent (table 2). Roughly two-thirds of global OFDI flows in 2008 were directed toward developed countries, about one quarter to developing countries (in particular to Asia) and roughly 5 percent to transition economies.

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[1] See UNCTAD, *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development* (Geneva: UNCTAD, 1999) and UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (Geneva and New York: UNCTAD, 2003).

[2] UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 247.

[3] UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 219.

[4] Karl P. Sauvant, 'The FDI recession has begun', *Columbia FDI Perspectives, No 1*, 22 November 2008. *Also* UNCTAD, *Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows* (Geneva: UNCTAD, 2009), p. 11. See also UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009).

Table 2 FDI outflows, by region and major economy, 2007–2008 (billions of US dollars)

	FDI outflows		
Region/economy	2007	2008	Growth Rate (%)
World	2,146	1,857	–13%
Developed economies	1,810	1,507	–17%
Europe	1,271	944	–26%
United States	378	312	–18%
Japan	74	128	+74%
Developing economies	285	293	+3%
Africa	11	9	–12%
Latin America and the Caribbean	52	63	+22%
Asia and Oceania	223	220	–1%
West Asia	48	34	–30%
South, East and South-East Asia	175	186	+7%
Transition economies	52	58	+14%

Source: Data from UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009).

The United States continued to be the most important source of OFDI, indicating the importance of the international investment regime to that country. OFDI from the United States accounted for 17 percent of total global OFDI flows in 2008, although OFDI from the US declined by 18 percent in 2008 as 'large repatriations of reinvested earnings and debt from foreign affiliates of the United States corporate sector took place and new investments abroad were halted'.[5] (The United States accounted for 22% of global OFDI flows in 1990–1994 and 20% in 1995–1999.) The Netherlands and the United Kingdom continue to be the largest host countries for FDI from the US; in 2008, the two countries accounted for over 27 percent of OFDI from the US (figure 2). Among industries, mergers and acquisitions or greenfield investments by US investors abroad were highest in finance and manufacturing (table 3).[6]

Global FDI inflows may well decline by as much as 50 percent in 2009; global outflows may decline by a similar percentage.[7] Even with this decline, however, the level of FDI flows remains significantly above that of the 1980s.

[5] UNCTAD, *Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows* (Geneva: UNCTAD, 2009), p. 11.

[6] Marilyn Ibarra and Jennifer Koncz, 'Direct investment positions for 2008: country and industry detail', in *Survey of Current Business*, vol. 89 (7) (July 2009), p. 22.

[7] UNCTAD expects FDI flows to fall to between $900 billion and $1.2 trillion in 2009; see UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 3.

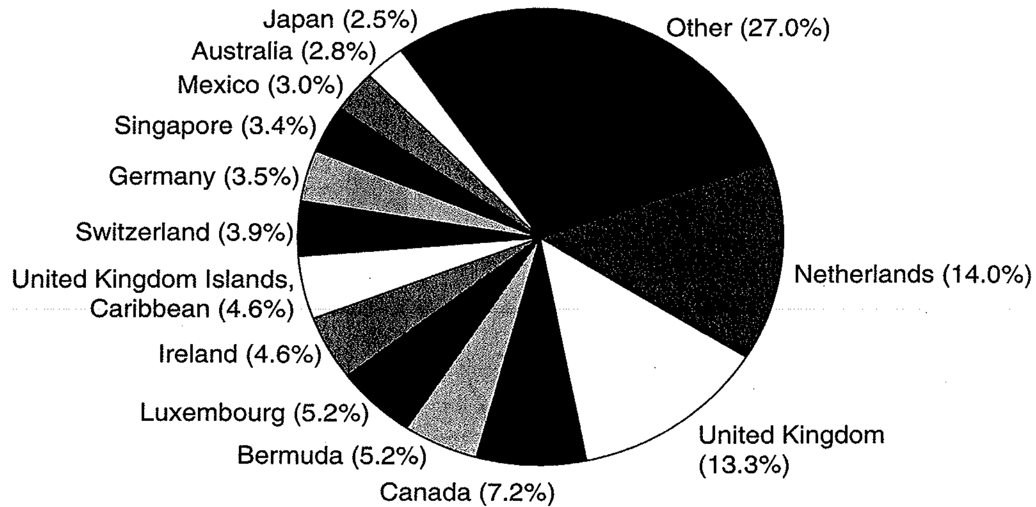

Figure 2 US Outward direct investment position, by country of foreign affiliate, year end 2008

Source: Marilyn Ibarra and Jennifer Koncz, 'Direct investment positions for 2008: country and industry detail', in *Survey of Current Business*, vol 89 (7) (July 2009), p. 21.

Table 3 US direct investment position abroad, by industry of US parent (millions of dollars), 2004–2008

Industry	2004	2005	2006	2007	2008
All industries	2,160,844	2,241,656	2,447,268	2,916,930	3,162,021
Mining	60,017	72,479	76,410	100,524	103,014
Manufacturing	1,197,349	1,218,774	1,331,968	1,542,868	1,667,338
Wholesale trade	63,625	71,562	88,950	102,458	117,760
Information	154,327	133,473	138,267	161,498	167,209
Depository institutions (banking)	92,659	104,061	96,681	158,940	193,248
Finance (except depository institutions) and insurance	310,727	341,422	411,157	493,124	500,998
Professional, scientific, and technical services	88,342	101,851	104,144	97,006	122,550
Holding companies (nonbank)	24,452	26,434	35,732	42,857	47,108
Other industries	169,347	171,601	193,961	217,655	242,795

Source: Bureau of Economic Analysis data.

The International Investment Regime

The rise of FDI has gone hand in hand with an increasingly open and protective regulatory environment that, especially since the mid-1980s, has become more welcoming for foreign direct investors. Countries have liberalized national entry conditions for MNEs, instituted various measures actively to attract such enterprises (eg through incentives and the establishment of investment promotion agencies) and facilitated the operations of foreign affiliates once established.

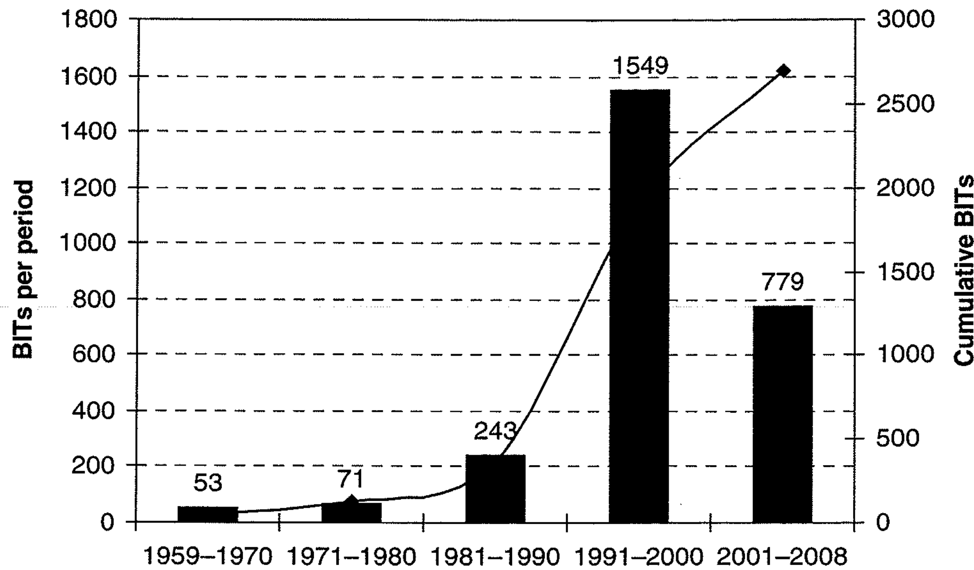

Figure 3 Growth of BITs from 1959–2008, by period and cumulative
Source: UNCTAD, <http://www.unctad.org/iia>.

These national regulatory changes have been complemented by international investment agreements (IIAs), particular bilateral investment treaties (BITs), whose main purpose is to protect foreign investors. By the end of 1970, only 53 BITs had been signed (although many of them were still relatively weak—compared to now—in terms of protections and dispute settlement). Their number began to grow slowly during the 1970s (when 71 BITs were signed), blossomed during the 1980s (when 243 BITs were signed) and really took off in the 1990s (between 1991 and the end of 2000, 1,549 treaties were signed), for a total of 2,695 BITs at the end of 2008, involving 179 countries (figure 3). As of August 2009, the United States had signed 48 BITs.[8]

Increasingly, moreover, commitments for the protection of international investment, and indeed the liberalization of entry and operational conditions, are also included in free trade agreements; in fact, the great majority of modern free trade agreements are also free investment agreements (figure 4). The US is party to a number of such agreements, including NAFTA and various bilateral free trade agreements with investment provisions.[9]

[8] US Department of States, United States Bilateral Investment Treaties (updated 3 March 2008), <http://www.state.gov/e/eeb/ifd/bit/117402.htm> (last accessed 13 August, 2009).

[9] Since the beginning of 2004, the US has concluded bilateral free trade agreements with investment provisions with Australia (2005), available at: <http://www.ustr.gov/Trade_Agreements/Bilateral/Australia_FTA/Final_Text/Section_Index.html>, Chile (2004), available at: <http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html>, Morocco (2006), available at: <http://www.ustr.gov/Trade_Agreements/Bilateral/Morocco_FTA/FInal_Text/Section_Index.html, Oman> (2006), available at: <http://www.ustr.gov/Trade_Agreements/Bilateral/Oman_FTA/Final_Text/Section_Index.html, Peru> (2009), available at: <http://www.ustr.gov/Trade_Agreements/Bilateral/Peru_TPA/Final_Texts/Section_Index.html>, and is also part of the Dominican Republic-Central American

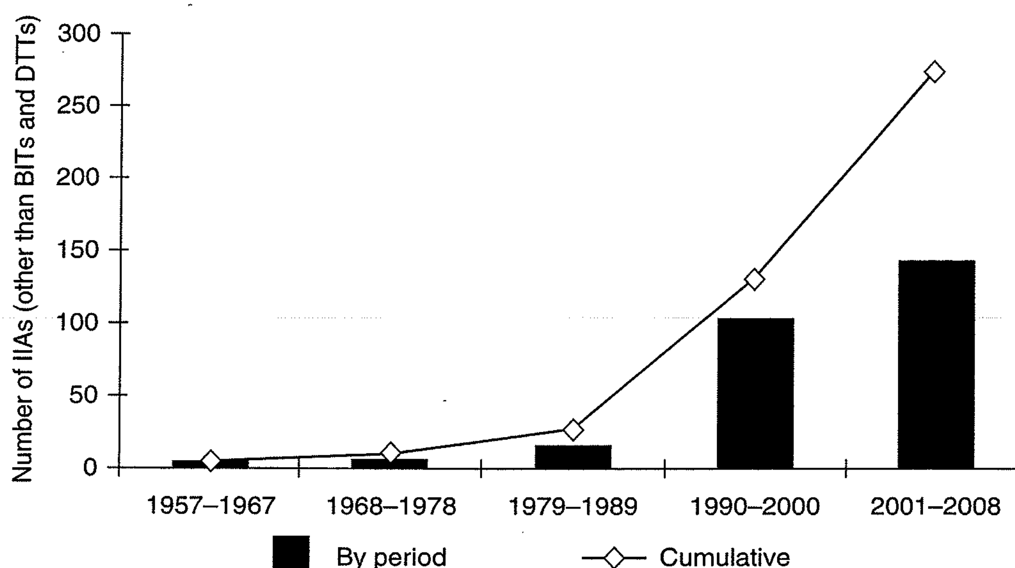

Figure 4 Number of IIAs other than BITs and double taxation treaties concluded, cumulative and per period, end of 2008

Source: UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009), p. 34.

As a result, and even in the absence of a multilateral investment treaty,[10] a relatively strong international investment regime has emerged. It is enforced, moreover, through an investor-state dispute settlement mechanism that is increasingly used by firms to protect what they see to be their rights: there were at least 317 known treaty-based international investor-state disputes by the end of 2008,[11] with 30 percent of them brought by investors during 2006–2008 (figure 5). The US had been involved, as of 16 August 2009, in 16 disputes, all of them arising under NAFTA Chapter 11.[12]

FTA (2006), available at: <http://www.ustr.gov/Trade_Agreements/Regional/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html>. The US-Columbia FTA, the US-Republic of Korea FTA, and the US-Panama FTA have investment chapters, but are still awaiting approval by Congress (<http://www.ustr.gov/Trade_Agreements/Bilateral/Colombia_FTA/Final_Text/Section_Index.html>, <http://www.ustr.gov/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Final_Text/Section_Index.html> and <http://www.ustr.gov/Trade_Agreements/Bilateral/Panama_FTA/Section_Index.html>).

[10] There are several multilateral treaties that cover aspects of international investment, most notably the GATS and TRIMs agreements of the WTO, as well as MIGA.

[11] Only ICSID reports the number of cases; hence the actual number of disputes is likely to be higher. UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development* (Geneva: UNCTAD, 2009). For a discussion of the reasons for this explosion of investment disputes, see Jeswald W. Salacuse, 'Explaining the increased recourse to treaty-based investment dispute settlement', in Karl P. Sauvant with Michael Chiswick-Patterson, eds., *Appeals Mechanism in International Investment Disputes* (New York: Oxford University Press, 2008), pp. 105–126.

[12] <http://www.state.gov/s/l/c3741.htm>.

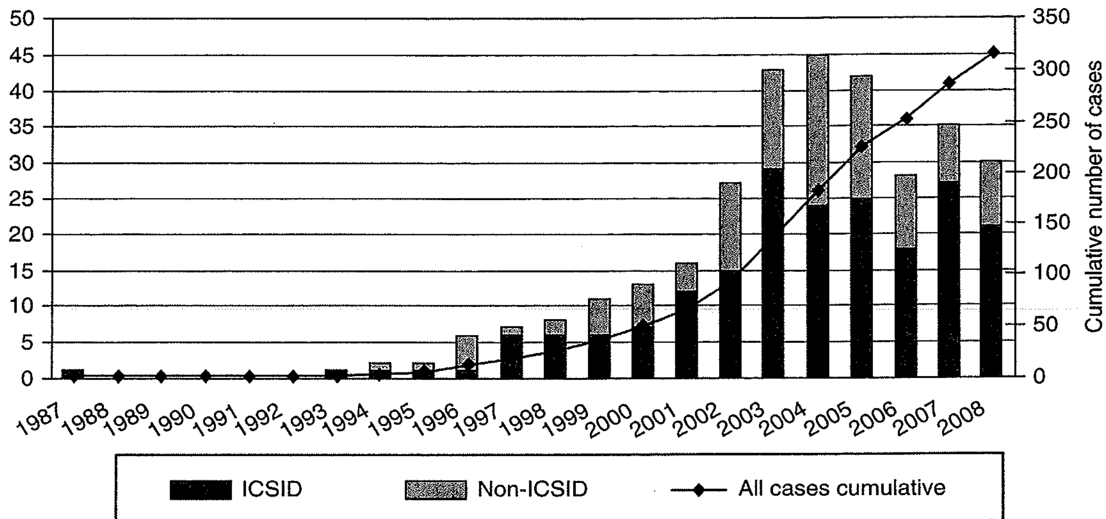

Figure 5 Known investment treaty arbitrations, cumulative and newly instituted cases, 1989–2009

Source: UNCTAD, 'Latest developments in investor-State dispute settlement', IIA Monitor No 1 (2009), UNCTAD/WEB/DIAE/IIA/2009/6, available at: <http://www.unctad.org/en/docs/webdiaeia20096_en.pdf>.

Political Risk

Notwithstanding a relatively strong international investment regime that gives some security to international investors, MNEs are becoming increasingly concerned about political risk in host countries. For example, a global survey by the Economics Intelligence Unit of 602 executives carried out in 2007 indicated a growing perception among major MNEs that political risk is on the rise, in fact, political risk was perceived to be more significant than economic risk, especially in developing countries.[13] Moreover, these risks were expected to increase.

'Political risk' refers to the possibility that investments will be impaired by certain types of government measures. More specifically, the United States' Overseas Private Investment Corporation (OPIC) defines political risk as 'the possibility that political decisions or political or social events in a country will affect the business climate in such a way that investors lose a portion of their investment or expected return'.[14] In light of the seemingly increasing political risk, political risk insurance has become increasingly important.

International investors can make use of different tools to mitigate political risk. Some governments, especially of developed countries, offer political risk insurance to protect the foreign investments of their domestic firms. Governments typically

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[13] *World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk* (New York: Economist Intelligence Unit and Columbia Program on International Investment, 2007).

[14] Overseas Private Investment Corporation, 'Political Risk', available at: <http://www.opic.gov/insurance/political-risk> (last visited 7 January 2010).

provide such insurance through public export credit or investment insurance agencies, such as OPIC. In addition, some multilateral organizations (like MIGA) provide political risk insurance to investors investing in their member countries.

Although political risk is a key concern for international investors, investment insurance determinations have not received significant attention. Both the academic literature and practitioner manuals have concentrated on investment agreements concluded by international investors directly with a host state, or, alternatively, the protections afforded international investors by international investment agreements and the arbitration mechanisms they typically provide. This focus neglects another means available to many international investors to protect against political risk: investment insurance.

The United States first made available political insurance products in connection with the Marshall Plan and later through the United States Agency for International Development (USAID) as part of its foreign development aid. The United States later formed a stand-alone investment insurance program in 1971 under the umbrella of OPIC. OPIC remains an agency of the United States, organized pursuant to an act of the US Congress.[15]

From 1971 to 2008, OPIC has funded, guaranteed or insured more than US$180bn in US outbound investments.[16] Until recently, however, OPIC's claims determinations have remained largely out of the public eye. The determinations, available for the first time in their totality, display a mature approach to political risk. This approach deserves independent study, as well as investigation in the context of more widely disseminated political risk conceptions, such as those that have been articulated in investor-state arbitration awards.

OPIC Investment Insurance Coverage

OPIC investment insurance against political risk is available to protect against a number of distinct types of events: (i) inconvertibility of funds; (ii) expropriation; (iii) political violence; (iv) losses caused by material changes in project agreements unilaterally imposed by the host state; and (v) terrorism.[17] OPIC's inconvertibility coverage had significant historical value. Due to the increased globalization of trade after the collapse of the Soviet Union, however, inconvertibility has since lessened in importance with both expropriation and political violence coverage leading to a far greater number of claims in more recent years.[18] In the current

[15] See 22 USC Section 2191 et seq.

[16] See OPIC Annual Report, at p. 3 (2008).

[17] See OPIC Handbook, at pp. 16, 20, 23 (2008), available at <http://www.opic.gov/pdf/OPIC_Handbook.pdf>.

[18] After 1989, inconvertibility cases arose only in the context of the Argentine banking crisis. See *First Trust of New York, National Association—Argentina*, at [vol. 2, p. 881] (2002).