Competition for Global Investment Coming from State-Owned Enterprises

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State-owned enterprises have played a relatively minor role in the era of investment-driven globalisation that began in the 1970s. As recently as 2007, when annual flows of foreign direct investment by multinational enterprises reached a record US$2 trillion, state-owned enterprises were sitting on the sidelines, accounting for only 3–4 per cent of international mergers and acquisitions, the main vehicles multinational enterprises use to acquire and control international operations.

This situation began to change with the onset of the global financial crisis in 2008. By 2009, state-owned enterprises had come to account for one fifth of international mergers and acquisitions. For some countries, especially among the resource-rich emerging economies, state-owned enterprises represent their main source of international capital.

There are reasons to believe that the emergence of state-owned enterprises as important sources of international investment might not be a transient phenomenon.

First among them is China. The combination of a sizeable state-owned enterprise sector in the domestic economy and a policy of encouraging outward investment has seen the country make the transition from being mainly a capital importer to being one of the world's leading sources of foreign direct investment. In addition, China is not the only source of international investment by state-owned (or controlled) enterprises. Emerging markets in the Middle East and Southeast Asia, as well as resource-rich industrialised countries such as Norway, have also become increasingly active international investors.

The emergence of multinational state-owned enterprises has become a cause for concern among governments. These concerns include potential threats to national security, the loss of control over natural resources and the possibility that state- owned enterprises enjoy advantages, such as preferential access to finance, which will give them an unfair competitive advantage against their private-sector counterparts.

In addition to these national-level concerns, international investments by state-owned enterprises give rise to a number of potential problems of a more multilateral nature.

At the top of the list, there is the question of the long-term competitive viability of state-owned enterprises as international investors. One persistent theme in international business literature has been the 'liability of foreignness' and the challenges faced by a multinational enterprise. This literature is rife with examples of spectacular business failures, usually involving overly ambitious expansion plans, including those of experienced multinational enterprises.

The rapid rise of state-owned enterprises as international investors is probably not due to a sudden surge in these firms' strategic agility and competitiveness. Rather, a combination of macroeconomic and policy factors has been pushing them to expand outside their domestic markets. This has especially been the case for Chinese state-owned firms. It therefore seems possible that the surge in international investment by SOEs represents an outward foreign direct investment bubble, driven in particular by China's energetic pro-outward- investment policies and fuelled by the country's foreign exchange reserves.

The collapse of the bubble, if indeed it exists, would significantly disrupt the global value chains into which state-owned multinational enterprises have integrated themselves. It would also affect the countries for which these enterprises have become major sources of capital (especially the resource-rich developing economies) and the home countries of SOEs that have squandered resources in support of overly ambitious international expansion strategies. In addition, governments that have used state-owned enterprises to secure access to resources they view as essential to their long-term national interest could find disruptions in their ability to acquire certain intermediate inputs.

These are mostly potential rather than actual concerns. It is not difficult to find individual examples of all of these problems, but for the time being there is no clear evidence of a systemic state-owned investment problem.

Nonetheless, governments have started to respond, although so far this response has been modest. At the national level, a few countries (for example, Australia and Canada) have reviewed and clarified their review processes for investments by foreign state-owned enterprises. Internationally, bilateral investment treaties increasingly stipulate coverage for investments by SOEs. In addition, although it is too early in the negotiations to tell, the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership could eventually include provisions in support of competitive neutrality.

On the one hand, this limited policy response reflects the fact that, at a time when global investment flows remain 40 per cent below their pre-financial crisis levels, governments do not want to discourage any source of international investment. On the other hand, it probably also reflects the serious challenges involved in breaking new ground in international investment rule-making at a time when many features of the existing global investment regime are being challenged, including investor-state dispute settlement and the growing complexity of a system made up of thousands of different bilateral and regional investment agreements.

Unfortunately, the lack of any clear initiative at the international or multilateral levels (such as was done to address concerns over investments by sovereign wealth funds in the Santiago Principles in 2009) holds the danger that governments will increasingly develop policy responses at the national level where the scope for opacity, political capture and ultimately protectionism is greatest.

As new actors in globalisation, state-owned enterprises reflect only one of the ways in which the nature of international investment and the structures of multinational enterprises continue to evolve. They are an example of how the realities of globalisation are leaving the global investment policy regime behind. Just as laws and regulations support well-functioning markets at the domestic level by ensuring fair competition, encouraging innovation and supporting responsible business conduct, the same logic holds at the international level.

If nothing else, the rapid growth of international investments by state-owned enterprises and the policy concerns that these are raising have highlighted the need to develop new multilateral options to help governments deal with the policy challenges of multilateral investment.

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