OpinionAsia 26 July 2007.

Saying No! Foreigners and the Birth Pangs of New Protectionism

Joergen Oerstroem Moeller26 Jul 2007
Irrespective of these obstacles, trade negotiators may still find the magic formula for a solution, although there is a greater likelihood that the issue will be relegated to the back burner - the risk of a kind of semi-protectionism will unquestioningly grow as the run up to the US presidential election gains pace.

Saying No! Foreigners and the Birth Pangs of New Protectionism

Joergen Oerstroem Moeller | **26 Jul 2007**

Much attention has been fixed on the efforts to achieve a break through in the global trade negotiations known as the Doha round. After the US Congress decided a few weeks ago not to renew President Bush's fast track authorisation of trade agreements, doubts have been raised as to whether US can honour agreements entered into by the executive branch. Irrespective of these obstacles, trade negotiators may still find the magic formula for a solution, although there is a greater likelihood that the issue will be relegated to the back burner in favour of political dividends for protection against foreign competitors - the risk of a kind of semi-protectionism will unquestioningly grow as the run up to the US presidential elections gains pace.

Meanwhile and without much notice, a completely different and in the long run far more substantial problem for the open and liberal trade and investment system has emerged. It popped up a couple of years ago when the US government was forced to step in to prevent a Dubai-led consortium (Dubai Ports World) to gain financial control over six US harbours. The same sentiment blocked the Chinese state oil company CNOOC's plan to acquire a relatively small US oil company, Unocal. Likewise, Haier, another successful Chinese company that specialised in kitchen equipment was also stopped in its tracks before it could buy Maytag.

France adopted a similar stance by reacting strongly to rumours that Pepsico had its eye on the French food giant Danone. Almost immediately the then French Prime Minister, Dominique de Villepin let it be known that his government regarded certain segments of France's economic life of strategic importance to the economy that should not fall into the hands of foreigners.

In principle such reactions are not new. However a new wave of protectionism does seem to be gathering strength, suggesting a completely new ball game. Governments are increasingly worried and on their guard about "foreigners" on the prowl, looking to purchase domestic companies.

There are several reasons for this attitude. The newest and most powerful one is the blurred picture of ownership that arises when the acquirer is an investment fund or a similar legal body. Over the last five to ten years, such funds have amassed colossal fortunes and are looking to buy enterprises for profit. In many cases, like private business, these funds have a nose for short-term profit with little or no concern over the repercussions and middle to long-term impact of their acquisition on the domestic economy. The often-suggested commitment to corporate social responsibility by these cash-rich funds in reality often serves as a weapon to beat off sceptics and cynics.

Governments worry that strategic enterprises with the intellectual capital, financial-know how, technology and management will come under control of other enterprises that in principle may use these assets to the detriment of the said nation-state and/or other enterprises within its national economy. Such a scenario burgeons exponentially when one does not know who the new owners really are. If legal construction casts a veil over ownership, the nation-state does not have any clue who is getting access to assets and how that new access will be employed, or worse, abused.

The problem becomes very worrisome, to the point of raising alarm bells within host governments, when sovereign funds (funds under control of other governments) enter the game as active acquirers. In such cases, there is little ambiguity about who the new owners are - it is all too obvious.

Presently, sovereign funds from China, Russia and the Middle East are reckoned to sit on 2.5 trillion US Dollars, and the prognosis suggests that global sovereign funds will have a war chest of 12 trillion US dollars in 2015 - larger than US Gross Domestic Product in 2006. With such colossal sums at their disposal, these funds acting more or less under supervision by their governments, can ostensibly assert control over large parts of the economy in other countries.

This has led to an initiative by the Chancellor of the Federal Republic of Germany, Angela Merkel for action from the European Union to set up a body similar to the US Committee on Foreign Investment (CIFIUS) designed to vet possible acquisitions of European enterprises. Mrs Merkel did not mince her words last week in framing the problem - these so-called "sovereign funds" were often driven by "political and other motivations", rather than the investment returns that drive privately controlled funds.

If this had come out of Paris the world might not have taken much notice other than filing it with similar statements uttered previously, but coming from Germany, it represented a new tune and more specifically, a point of departure. The matter was deemed sufficiently important to merit attention from the newly appointed British Chancellor of the Exchequer, Alistair Darling in his first address to the House of Commons on 25 July. His comments were made just as rumors were afloat that the Sainsbury supermarket group was considering a £10.4 billion takeover offer from Delta Two, a fund backed by the Qatari royal family. Darling was quoted as saying that Britain was open to inward investment by Chinese, Middle Eastern and Russian firms as long as it was in accordance with International Monetary Fund regulations on governance and

transparency, but not before adding that he expected foreign governments to allow for reciprocal investments by British companies.

The issue has reached a point where it is far too serious to be neglected. In the years to come, there is a greater likelihood that investment funds and separately, sovereign funds will grow phenomenally. Their appetite on purchasing profitable, well-run, high tech enterprises will be insatiable. A defensive attitude that seeks to block such acquisitions by major countries will make these funds homeless in the search for alternatives that are not easily found.

There is no self-evident answer to the question of what must be done, but if the international community neglects the issue and abandons its duty to sketch international rules and norms, we may well see a repetition of Mrs Merkel stance, with each state applying its own specific rules to deal with cross-border and transnational investments. That may well push the international investment and trade regime into unchartered waters. And such waters may well host bad weather that causes long-term damage.

Joergen Oerstroem Moeller is a Visiting Senior Research Fellow at the Institute of Southeast Asian Studies, and an Adjunct Professor at the Copenhagen Business School.