

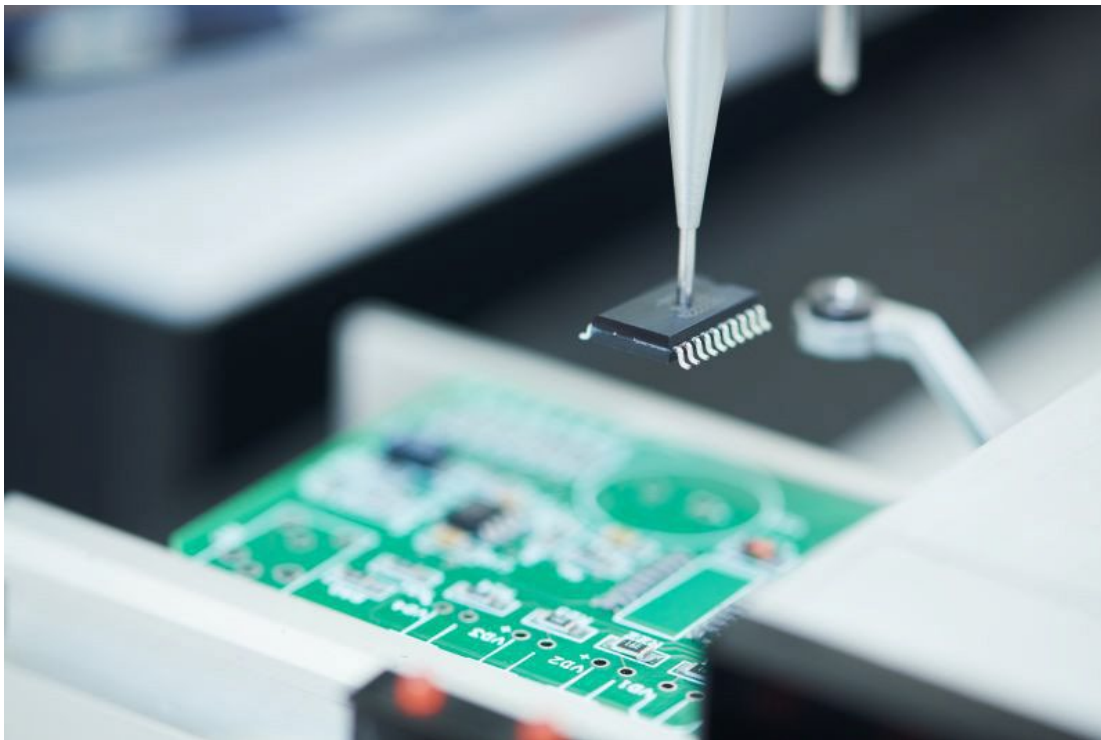
Corporate

National security regulation of foreign investment is globalization's new normal

In his latest quarterly IFLR National Security Column, Harry Broadman argues the world is in just its first phase of proliferating national security regulation of FDI

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Established in 1975, Washington's interagency executive branch foreign investment screening entity – the Committee on Foreign Investment in the United States (CFIUS) – not only pioneered national security regulation of inbound investment transactions, but for decades also marked the US as virtually the only country possessing such a regime.

The irony of the juxtaposition of the world's most ardent champion of liberalised investment and trade flows being such a pioneer was – oddly – rarely voiced by America's international economic partners. In fact, it became seen as business as usual.

Today, half a century later, many other countries – indeed mostly other advanced democracies – are in the process of either creating their own foreign investment regulatory regimes or strengthening

nascent frameworks on this score. State-dominated nations, too, are now further intensifying such regulatory practices, which are, of course, part and parcel of the fundamental policy tenets that define their economic systems.

As national security regulation of inbound foreign investment matures across the globe, will the next phase of such regulation focus on outbound foreign investment transactions?

CFIUS: the global beacon

Much of the recent proliferation around the globe of initiatives to regulate national security risks of inbound foreign investment has been driven by the accelerated rise of China in the world economy over the last few decades and its staying power. Compounding this was US enactment in 2018 of the nation's first wholly CFIUS-dedicated statute, FIRRMA (the Foreign Investment Risk Review Modernization Act), and unusual for lawmaking by Washington, was its passage by Congress almost unanimously and on an overwhelmingly bipartisan basis.

In contrast, much of the impetus behind CFIUS' creation was Japan's increasing global economic strength – a phenomenon that, over time, has waned. Moreover, the initial legislation was a relatively obscure amendment to a core law of US defense policy. At that time, I was a U.S. Senate Committee staffer involved in drafting the trade statute that ultimately contained the amendment, and subsequently, when serving in the White House, was a member of CFIUS.

FIRRMA and its subsequent implementing regulations set out systematically, and in great detail, CFIUS' operating principles, procedures, and sectoral classifications where national security oversight of cross-border transactions, including those that were already consummated, would be most rigorous.

Around the time of passage of FIRRMA or soon thereafter, more than 25 countries either now have in place dedicated inbound investment review processes or are well on the way of doing so. Mostly this includes democracies, such as Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Iceland, India, Ireland, Japan, Latvia, Lithuania, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, South Korea, Slovakia, South Africa, Spain, the UK.

In addition, at the regional level, the European Union (EU) has established a bloc-wide information-sharing framework regarding inbound foreign investments by non-member countries. This provides a process for *all* EU members to raise issues about the national security implications of a prospective transaction in one member's market even if it does not directly involve capital flows across other members' borders.

State-dominated countries have also established or strengthened regimes to regulated foreign investment, most notably China, Russia, and Saudi Arabia.

At the same time, while some countries have not put in place unified or self-contained foreign investment regulatory statutory frameworks, they do screen such investment through other instruments and channels, including (i) limits or prohibitions on foreign ownership of land; (ii) restricting foreign investment through licensing requirements; and (iii) specifying sector-specific percentage limits for foreign investment.

Sectoral creep for defining sensitive sectors

The definition of what constitutes sensitive sectors in which foreign investment could pose a threat to

national security has accelerated significantly in the past few years. Arguably more than any other democracy, the US has been the most aggressive on this front, although other jurisdictions have now closely followed the US lead.

For several decades, the traditional focus was on regulating/banning foreign transactions in domestic firms or activities in bona fide defense and security operations. By the early 2000s, that was enlarged to include infrastructure facilities, some of which, on the face of it, seemingly had tenuous national security risks.

Arguably the most well-known case was the proposed transfer of contractual rights for port management services in several US ports from one foreign entity to another in 2006. The purchaser was to be DP World (DPW), a state-owned company in the UAE. The port services contracts were already owned by a British firm (Peninsular and Oriental Steam Navigation Company – P&O). Yet after DPW acquired P&O, the contracts were to fall under DPW control. Although the transfer already had been approved by CFIUS, US Congress passed legislation to block the deal.

A contrasting example was the 2013 sale of the pork products company Smithfield Foods to the Chinese firm Shuanghui. At the time, it was the largest Chinese purchase of a US company in history. As CFIUS was in the throes of its process of deciding whether or not to approve the sale, the US Senate Committee on Agriculture, in an unprecedented move, held hearings on the threat the proposed transaction would pose to the safety of the US food supply chain. It was truly a poignant moment in the politicisation of the CFIUS process – for two reasons.

First, the acquisition had little, if anything, to do with China's interest in sales of pork *within* the US market; rather Shuanghui's objective was to actually increase US exports of pork to China, which it has subsequently done.

Second, Smithfield Foods and its US advisors seemingly had blinders on as to their fundamental understanding of the perceived political ramifications of the deal as seen through the eyes of US politicians (whether or not such perceptions were rational). Indeed, Smithfield was stunned that a deal combining the elements "China" and "US food" would even merit *voluntary* notification to CFIUS. Given all that has transpired in the political realm of Chinese investment in the US over the past couple of decades, to say this reaction was naïve would be an understatement. Nonetheless, the transaction was consummated.

Over the past few years, the concept of national security within the CFIUS process has broadened beyond defense and security assets; infrastructure; and real estate, and now includes personal data. This is increasingly true in other countries as well. Nothing personifies this more than the Trump administration's machinations over the proposed divestiture of the Chinese firm ByteDance's TikTok app. The mishandling of the case served only to undermine the stature of the [US as the global beacon for certainty and clarity of nations' policies toward foreign investment](#).

Coordination and disclosure on the investor side: no longer just a bilateral process

The jurisdictional proliferation of national security regulation of foreign investment has ushered in a dramatic change in the way in which investors – especially multinational corporations – engaged in cross-border transactions must now navigate the screening process. Not surprising, taking a bilateral approach is increasingly unlikely to get very far. The fact is that many governments regularly share data.

In the case of the US, FIRREA mandates CFIUS to engage in such practices. The goal is to facilitate harmonisation across countries wherever there is a coincidence of interests. The result is that even where multiple jurisdictions have similar foreign investment screening frameworks, parties to a transaction will need to plan carefully to succeed through multi-jurisdictional review processes,

bearing in mind that the review process undertaken by CFIUS is arguably the most challenging of its kind in the world.

Will the US establish national security regulation for outbound foreign investment?

A new chapter in US regulation of foreign investment may well be in the offing: national security screening of *outbound* investment by US firms.

Urged on by the Biden White House, legislation in the final stages currently pending in the US Congress – still subject to reconciliation between Congress' two houses, their final vote and then signature by the President – contains provisions that could subject certain investments made abroad by US firms to regulatory approval.

Propagated by concerns about US entities “offshoring” advanced technology development, production capabilities, and supply chain operations that are deemed vital to US manufacturing, the legislation seeks to establish a US Committee on National Critical Capabilities (CNCC) that would operate similarly to CFIUS.

Several sectors are being highlighted in the pending statute: (i) medical supplies, medicines, and personal protective equipment; (ii) components essential to the operation, manufacture, supply, service, or maintenance of critical infrastructure, including that required following natural or manmade disasters; and (iii) components determined to be critical to military and intelligence systems and operations.

Given the votes taken to date on various sections of the legislation, it would be surprising if, in some form, such a law is not ultimately enacted. If that comes to pass, [one would be hard pressed not to believe that other countries would follow suit](#) – both democracies and state-dominated economies alike.

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