The world is at the advent of a 4th Industrial Revolution. Advances in artificial intelligence, machine learning, Big Data and the so-called Internet of Things, among other things, promise to upend business models around the world and change the way we live in unimaginable ways. But the re-emergence of nationalism as a potent force in geopolitical rivalry threatens the global spread of this new technological transformation. Asia will be an important battleground in this looming ‘technology war.’

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Regulators Join Tech Rivalry with National-Security Blocks on Cross-Border Investment

By Vinod K. Aggarwal & Andrew W. Reddie

Fueled by a perception that China is becoming a strategic rival rather than a partner in the liberal global order, there are growing concerns about Chinese investments in strategic sectors abroad, not just in the US but also in Europe and elsewhere. Investments in key emerging technologies are attracting particular attention.

Vinod K. Aggarwal and Andrew W. Reddie lay out the wide-ranging regulatory frameworks being put into place to submit foreign direct investment to greater scrutiny on national-security grounds. They are a new battleground in the war for technological supremacy.

In 2018, the US passed legislation to expand the oversight procedures of the existing Committee on Foreign Investment in the United States (CFIUS) to include even minority stakes in American companies — including those from venture-capital and private-equity firms. China, too, passed a new law to address concerns about forced technology transfer in 2019, but still has significant oversight of foreign investment through its 2015 National Security Act, focusing on cybersecurity and critical technology. Germany has also become sharply concerned about Chinese FDI, in particular, and passed an amendment to its existing rules in December 2018 that lowers the threshold to review FDI deals from 25 percent to 10 percent.

The national-security reviews by member states. This essay analyzes the evolution of M&A rules driven by concerns over national security. We provide a brief history of CFIUS to examine its performance before noting its perceived limitations that led the US Congress to pass the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018. We then examine similar international efforts to address cross-border investment and discuss the potential consequences of these developments. Finally, we focus on the importance of three key issues: the problem of national security becoming an open-ended excuse for protectionism, how to address early-stage investments in emerging technologies, and whether active government participation in a host of industries will achieve its intended goal.

THE EVOLUTION OF CFIUS

To understand the significance of new legislation and its potential effects on FDI, it is worth revisiting the history and evolution of CFIUS in the United States. Here we outline its evolution since its inception by Executive Order in 1975. Specifically, we point to the various amendments and to the processes that have been proposed and implemented to address concerns regarding the role of foreign investments in the economy and the interaction between domestic markets and national security.

Upon its creation, CFIUS was focused primarily on information and data collection — although it remained unclear what its role ought to be. It wasn't until the 1980s that Japanese acquisitions in defense-related sectors including steel, manufacturing, and semiconductors, along with the 1988 Exxon-Florio Amendment outlining how CFIUS should review foreign investments, resulted in the presidential authority to block mergers, acquisitions, or takeovers. The standard for making this decision included “credible evidence” that the foreign investment under investigation would impair national security. The amendment also played a role in outlining the voluntary notification of acquisitions to CFIUS and made clear that these declarations would be confidential.

The Byrd Amendment later required CFIUS to investigate mergers, acquisitions or takeovers in which: 1) the acquirer is controlled by or acting on behalf of a foreign government; and 2) the acquisition results in control of a person engaged in interstate commerce in the US that could affect the country’s national security. It is worth pointing out that there would be later disagreement concerning the degree to which these reviews were discretionary or mandatory — particularly in the case of Dubai Ports World in 2006, concerning the management contracts for six US ports and its potential sale to DP World — a state-owned firm in the United Arab Emirates (UAE). These contracts were already foreign-owned by the British firm P&O, but when...
P&O was acquired by DP World, Congress voted to block the deal. DP World would eventually sell P&O’s management contracts for the six US ports to AIG, a US firm.

The DP World episode led to changes in the CFIUS process via the Foreign Investment and National Security Act of 2007 (FINSA). FINSA added “critical industries” and “homeland security” as broad categories of economic activity subject to CFIUS review; set out to define the standards for investigation; and gave CFIUS statutory authority. FINSA also sought to better define the circumstances in which an investigation would be appropriate, pointing to a threshold of 10 percent of voting securities as a standard for “controllability” as well as judgments by CFIUS members concerning board seats. The act also made clear that passive investment vehicles—investment funds, banks and insurance companies—carrying out their normal business do not constitute grounds for investigation.

From its inception to the present, five acquisitions have been blocked through the CFIUS process. President George H.W. Bush directed China National Aero-Technology Import and Export Corporation (CATIC) to divest its acquisition of MAMCO Manufacturing in 1990. More recently, President Barack Obama directed the Chinese-owned Ralls Corporation to divest from an Oregon wind farm project and blocked a Chinese investment firm, Canyon Bridge Capital Partners, as well as the acquisition of semiconductor chip maker Qualcomm by Singapore-based Broadcom for US$117 billion.

Looking at the five acquisitions that US presidents have decided to block, however, doesn’t tell the whole story — given the selection effects concerning those investigations that run their course. Indeed, several mergers and acquisitions have been abandoned or reconstituted — including the DP World case noted above — to avoid being blocked through the CFIUS process.

**NEW DEVELOPMENTS IN US FOREIGN-INVESTMENT RULES**

As noted, the CFIUS process has been predominantly focused on controlling stakes taken by foreign companies in US companies or multinational companies with contracts related to US critical infrastructure. These “traditional” pathways of regulation, however, turn a blind eye to how a number of countries engage with American companies, particularly those in the technology sector working on emerging technologies — including artificial intelligence, quantum computers and next-generation space systems. The role of Chinese investment funds as well as Chinese funding for traditional venture-capital firms in the US has been well documented — though largely absent from the public discourse, which instead has focused on procurement guidelines — specifically related to Huawei and ZTE — and US-China trade concerns.

The 2018 FIRRMA legislation puts these issues back on the agenda. It expands the types of foreign activity in the US market that are subject to oversight. Specifically, FIRRMA lowers the threshold for investigating foreign investment to include any foreign “non-passive” investment in companies involved in critical technology. The technologies discussed during the floor debate concerning the passage of FIRRMA in the House of Representatives included artificial intelligence, robotics, augmented and virtual reality, new biotechnologies, new financial technologies, and advanced materials. According to Croley et al., FIRRMA changes the jurisdictional framework by extending CFIUS review to “any investment that relates to a US business owning or maintaining ‘critical infrastructure’; a business involved in the development, design or production of ‘critical technology;’ or a business collecting or maintaining ‘sensitive personal data’ of US citizens, in the event that the investor acquires (in connection with the investment) “any material non-public technical information;” is granted membership or observer rights on any board of the business; or has “any involvement” in the decision-making of the business.”2

Importantly, this means that transactions that do not lead to foreign control of a company are still subject to disclosure, review and investigation.

For some, this is a welcome amendment to the CFIUS review process. The US Department of Defense’s Defense Innovation Unit (DIU), formerly DIUx, has a series of reports outlining how Chinese investments have contributed to technology transfer across the Pacific — arguing that the existing CFIUS review process has only been partially effective.

There are clearly significant challenges associ-
Global Asia: Battle Lines: Technology Rivalry and the Rise of Nationalism


International Regulations on FDI

Countries have long sought to regulate FDI through unilateral, bilateral, mini-lateral and global arrangements. While not always explicitly focused on national security, such concerns often underlay efforts to restrict the amount and types of investment. In 1971, the Andean Foreign Investment Code sought to influence the formation of the regulatory regime driven by emerging technologies and a changing geopolitical landscape.

In Europe, the UK has moved forward to strengthen national security reviews of investment, rather than only relying on the existing Competition and Markers Authority (CMA), which is based on a 2002 law that allowed the government to examine mergers based on national security considerations. The new approach, proposed in a July 2018 White Paper, specifies triggering events based on varying levels of shares and assets. While parties to a transaction are encouraged to voluntarily submit their proposed acquisition to the government, the government can initiate a review of transactions on its own. In terms of likely impact, the White Paper predicts that approximately 200 cases will be subject to review on a yearly basis, with about 50 requiring some mitigating action on the part of the parties in light of national security concerns. In response to this proposed approach, which is likely to be instituted by 2020, venture-capital (VC) firms, law firms, pension funds and others have expressed concern about the possible uptick in cases that will fall under national security review. Under the 2002 law, only nine cases were subject to government intervention.

In continental Europe, France has regulated and blocked FDI since 1966. Its 2004 law expanded the sectors that would be subject to review from weapons to include infrastructure investments such as electricity, gas, oil and water. Pending approval of the French Senate, the PACTE Law first proposed in June 2018 will expand its sectoral overview to AI, data, space, cybersecurity, dual-use goods, robotics and the like. The bill gives the government the right to suspend voting rights and dividend distributions, appoint a trustee in the company to oversee French interests, and sell French assets. Moreover, both acquiring and target companies can seek a review by the Ministry of Economy for their opinion of the investment.

Germany has for the most part been very welcoming with respect to FDI, with few restrictions for national security. Very recently, this has begun to change dramatically. Since 2004, the German Ministry for Economic Affairs and Energy (BMWi) has had the power to review M&A activity in security-related industries including military equipment and IT products used for encryption. This review was extended in 2009 to include any M&A activity by non-European investors if a foreign entity acquired more than 25 percent of voting rights. In 2017, in the aftermath of concerns about a 2016 acquisition effort by a Chinese company of a German industrial robotics company and a proposed chip company acquisition, the scope of review was expanded to include critical infrastructure, cloud computing, telematics and some key software. The 25 percent threshold was lowered to 10 percent for sector-specific acquisitions that might impinge on national security, and the scope was expanded to include the media in December 2018.

In addition to these changes in German law, in early February 2019, breaking from longstanding German opposition to industrial policies at the federal level, the Minister of Economics, Peter Altmaier, proposed in a paper the “National Industry Policy 2030.” In it, he calls for both a preference for European-wide mergers over outsiders, including looser rules on mergers, and industrial policies including a national investment facility to prevent M&A efforts by non-European companies. In particular, he points to the critical importance of national and European capabilities in AI, autonomous driving, automated production, digitalization and the platform economy. This effort was followed just two weeks later by a joint French-German manifesto on a 21st century industrial policy. The manifesto calls for technology funding from the government in collaboration with the private sector, support for high-risk projects in new technologies, co-operation in R&D in AI, consortia, and better financing in general. Specifically with respect to M&A, without naming countries, it calls for consideration of “state-control of and subsidies for undertakings with the framework of merger control” and reciprocity in public procurement. There is little doubt that the goal of this effort is primarily to address Chinese industrial policy and investments. The manifesto also calls for implementation of an EU-wide screening procedure, to which we now turn.

The EU has long co-ordinated trade policy, but has done little with respect to creating common national security review policies on FDI. Currently, only 14 of the EU’s member states have a national-security screening procedure on FDI. But beginning with a European Commission proposal in September 2017 for the development of a framework to screen FDI entering the bloc, the EU’s governing institutions moved quickly, with approval by both the European Parliament and member-state governments by July 2018, leading to a proposed agreement on Nov. 20, 2018. Following approval by legislators this year, the framework is likely to come into effect in November 2020. The accord does not call for a single common policy but for information exchange on best practices and allows the commission.
the EU’s executive and regulatory arm, to “issue opinions in cases concerning several member states.” With respect to scope, the deal covers critical infrastructure and technologies, robotics, AI, cybersecurity, dual-use products, media, and broader infrastructure — similar to the coverage of the new German FDI laws.

In China, the Sino-Foreign Equity Joint Venture Law of 1978 permitted foreign investment, but with a host of strict regulations, management and oversight. In the 1990s, China created the Catalogue to monitor investments by distinguishing between investments that were encouraged, restricted and prohibited, thus providing sectoral restraints on investment. Examples of prohibited investments in the 1990s included the power industry, telecommunications, broadcasting, and military arms, among others, and created conditions on the type of technology that companies could bring in, setting the stage for later national security-oriented legislation. The Catalogue was replaced by a “negative” list, and in 2011, the government created a specific National Security Review process that focuses on M&A activities. Any domestic companies in defense-related industries, such as agriculture, energy, resources, transportation and technology could all be subject to review. The passage of the 2015 PRC National Security Law set the stage for a much more significant national security process on M&A, modeled in part on CFIUS. The first step was the June 2017 Cybersecurity Law, which affected network operators in the critical infrastructure and technologies, robotics, AI, cybersecurity, dual-use products, media, and broader infrastructure — similar to the coverage of the new German FDI laws.

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The temptation for protectionist interest groups to frame claims for protection in terms of national security in investment, just as they have in trade, may well prove irresistible. With the passage of FIRMA legislation in the US seeks to address this, but it remains an open question whether the opaque origins of investors in many venture capital and private equity firms will prevent technology transfer by foreign companies and impact the speed at which startups grow. FIRMA and efforts like it that have been undertaken abroad, while increasingly common, are not a panacea. Understanding their effects and limits represents an important subject of study for companies big and small as well as academics and lawyers.

WHAT’S NEXT?

We have seen a dramatic trend toward new regulations in the name of national security, driven in large part by growing Chinese investments that affect the inflow of FDI into countries. In our view, we must pay attention to three critical issues.

First, while we agree with the concerns underlying this trend, particularly in areas such as cybersecurity and emerging technologies that are dual-use (with civilian and military purposes), the question remains whether and how these new regulations will change the level of scrutiny concerning international investment.10 The temptation for protectionist interest groups to frame claims for protection in terms of national security in investment, just as they have in trade, may well prove irresistible. With the passage of FIRMA legislation in the US, and comparable legislation elsewhere, there is a real danger that national security reviews will be abused. Most of this legislation, while specifying particular industries that are “critical,” leaves a large amount of discretion in the various committees and enforcing bodies that are being set up. So far, at least in Western countries, the number of cases of national security reviews being used to block FDI has been remarkably small. But with new legislation on the books, and continued fear of China’s outward FDI push, it appears inevitable that the number of cases will grow rapidly.

A key question is whether the differing national approaches to national reviews of investment will lead to pressure to create an international regime to regulate what states are doing.

Second, the new emphasis on the regulation of investments by venture capital and private equity firms in the case of FIRMA raises an important issue regarding how it will carry out its regulatory function. As we have argued, the prior focus of both the US and other countries’ regulations on mergers and acquisitions may have been misplaced. If the goal of other states is to transfer key technologies across borders, there are alternative and more efficient vehicles for doing so, including early-stage investment. Over the last 30 years, innovation has been driven by startups backed by seed-stage and follow-up investments by venture capital funds. The new FIRMA legislation in the US seeks to address this, but it remains an open question whether the opaque origins of investors in many venture capital and private equity firms will prevent technology transfer by foreign companies and impact the speed at which startups grow. FIRMA and efforts like it that have been undertaken abroad, while increasingly common, are not a panacea. Understanding their effects and limits represents an important subject of study for companies big and small as well as academics and lawyers.

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