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ABSTRACT

After the Financial Crisis happened in 2008, investment protectionism has become rampant again around the world. For the consideration of the maintenance of national economic security and market stability, a number of countries start to take measures to set up barriers to restrict the entry and operation of foreign investment. After decades of development, the national security review system of the United States has gradually evolved into a potential tool of investment protectionism. The scope of the national security review has increasingly expanded, while the procedure of the national security review has been increasingly stringent. Gradually, it has become a stumbling block of foreign investment. International society should be vigilant to this phenomenon of investment protectionism, which is in the name of the national security review though.

KEYWORDS
Investment protectionism; Potential tool; US national security review system.

INTRODUCTION

The stabilization and improvement of the global economic and political environment during the postwar period create favorable external conditions for the recovery and development of the world economy. With the ever-accelerating process of economic globalization, the economic exchange and communication across various countries are becoming increasingly frequent around the world. However, the economic, political and social risks are also increasing therewith. In order to safeguard the national economic security and avoid the possible adverse effects given rise by the influx of foreign investment, a number of countries have taken measures to limit the inflow of foreign investment. These measures are necessary indeed, but if exceeding reasonable limits, they will evolve into investment protectionism, which aims at safeguarding domestic economy through the prevention or restriction of the entry and operation of foreign investment arbitrarily and discriminately. There are various forms of investment protectionism, among which the national security review system is the most prominent. Around 1970s, a number of western countries began to establish the national security review system over foreign investment. After 2008, foreign investment is becoming increasingly strict in procedures, and increasingly wide in scope. The investigation of foreign investment is becoming increasingly politicized. The national security review system has been playing the role of arbitrarily...
financial crisis, many countries have revised their relevant foreign investment legislation, to further strengthen the foreign investment regulation, among which the United States is the most typical one. The US national security review system of restricting unfavorable foreign investment in a discriminatory manner. Generally, the national security system has gradually become a potential tool of investment protectionism.

The entire article consists of five parts. Part 1 gives a brief introduction. Part 2 discusses the historical evolution of investment protectionism and summarizes its characteristics and influence. Part 3 explores the relevant legislation of the national security review system of the United States and its main contents. Part 4 attempts to demonstrate that the US national security review system constitutes a potential tool of investment protectionism. Part 5 concludes the article.

AN OVERVIEW OF INVESTMENT PROTECTIONISM

Investment protectionism has a relatively short history. It has a variety of characteristics and poses negative impacts on the development of international investment activities.

The Historical Evolution of Investment Protectionism

The rise of investment protectionism is closely related to foreign direct investment. After World War II, European countries urgently needed to restore their economy and promote employment. In order to protect their seriously-damaged industries, these countries maintained a high degree of vigilance and rejection of foreign investment. During this time, the United States accelerated its global expansion of foreign investment, which aroused western countries’ antipathy. As a result, measures aiming at restricting the foreign investment from the United States began to emerge. In addition, with the vigorous expansion of the national liberation movement, a large number of third world countries got rid of colonial rule and ushered in independence. These countries, in order to firmly control the core areas of their economy which related to the national security, launched a huge campaign of nationalization. Important industries once controlled and operated by developed colonial countries were gradually forfeited by the governments of these newly-emerging countries. At this stage, most countries were cautious about the entry of overseas investment. Investment protectionism began to sprout.

The tense political atmosphere finally eased after the end of the cold war. Global economic environment was improved and the countries around the world started to commit themselves to economic development. During this period, international investment system has been influenced by investment liberalization. Most countries have actively carried out political and economic policies to promote economic exchanges and cooperation. A large number of bilateral and multilateral investment agreements have been concluded. Consequently, the global investment system has come into being. Relatively, the investment protectionism imposed less negative influence during this period.

After the new millennium, overseas investment frictions among different countries began to intensify. The international investment environment plummeted after the 2008 financial crisis. Various forms of investment policies have been taken by numbers of countries to restrict or even hinder the inflow of foreign investment, so as
to avoid the deterioration of their domestic economic environment. As indicated by relevant statistics, during the period 1992-2002, 6% of all regulatory changes relating to foreign direct investment were in the direction of making the investment climate less welcoming. The share of unfavorable changes doubled to 12% of(597,59),(652,70)(695,59),(750,70)(313,59),(368,70) of all regulatory changes during 2003-2004, and again almost doubled to 21% of all regulatory changes during 2005-2007. Investment protectionism has increasingly overflowed, and overseas investment has been suffering unprecedented difficulties and challenges. Currently, investment protectionism is on the rise.

The Characteristics of Investment Protectionism

Investment protectionism has numerous characteristics. Specifically, there are at least three main ones, namely, the diversity of forms, the politicization of contents and the subjectivity of criteria.

Some scholars have pointed out that the investment protectionism has two main situations. Firstly, in terms of the inflow of international investment, investment protectionism involves measures by public authorities that are taken to prevent or discourage foreign direct investors from investing in, or staying in, a host country. Secondly, in terms of the outflow of international investment, investment protectionism refers to measures directed at domestic companies that require them to repatriate assets or operations to the home country or discourage certain types of new investments abroad. For the first type, there are a variety of specific forms of investment protectionism, such as the national security review system, market access restrictions and antitrust investigation, etc. Some scholars even believe that the exaggerated corporate social responsibility may be regarded as special form of investment protectionism as well. For the consideration of the maintenance of national economic security and market security, almost all countries tend to take measures to set up barriers to restrict the entry and operation of foreign investment. Objectively speaking, such consideration has no ground to be blamed and it is even necessary indeed. However, when it exceeds a reasonable limit, this investment protection practice will become a discriminatory tool.

In recent years, with the expansion of the amount of overseas investment, the number of the foreign M&A transactions which have been blocked has increased significantly. The original intention of the practice of investment protection measures is to avoid vicious competition and to maintain the security and stability of domestic economy. However, with the amplification of international investment, many countries have incorporated political factors into the foreign investment review system, making the original simple commercial activities become much more complicated than ever, which may enlarge the uncertainty and the risk of overseas investment. For instance, judging from the merger cases of American companies conducted by Chinese investors, the failure of most cases should attribute to the politicization of the American foreign investment review system.

The conduct of investment protection activities aims at safeguarding national security, especially national economic security. Yet, the concept of national security has not been clearly defined and the scope of national security has differentiated from each other. Therefore, the host country could give a broader interpretation over the definition of national security arbitrarily, which has strong subjectivity and great flexibility. It is under this condition that the investment protectionism has obtained the
The subjectivity of the criteria of national security provides the essential foundation for the spread and overflow of investment protectionism.

**The Influence of Investment Protectionism**

The spread of investment protectionism will give rise to a series of impacts, such as the impairment of foreign direct investment, the impediment of industrial upgrading, and the damage to the corporate image and so forth.

Investment policies and measures with the nature of investment protectionism will lead to the difficulty of the inflow of foreign investment. For enterprises or industries that have already entered into the market of the host country, the transactions may be forced to terminate. These potential adverse consequences may pose negative psychological effect on foreign investors. If things continue this way, the foreign direct investment will be affected seriously, and the enthusiasm of foreign investors will be frustrated severely. Further, the spread of investment protectionism will result in the sharp decline of the total amount of global investment, which will not be conducive to the healthy and stable development of world economy eventually.

In order to enhance the optimization and allocation of industrial structure, large amount of money and technology is required. Overseas investment provides the necessary financial support for the innovation and development of science and technology, which may promote local employment and improve people’s livelihood as well. However, investment protectionism policies and measures will hinder the flow of capital, and increase the cost of economic development of the host country. Meanwhile, it is not beneficial to the research and innovation of new technology, which may cause the slowdown of the speed of economic growth.

Normally, for some countries, the initiation of foreign investment review will attract public attention. Thus, the foreign enterprises involved will be placed at the center of media speculation. With regard to the foreign enterprise under review, any negative public opinions may seriously affect its corporate image, which may have unfavorable impacts on the result of the review indirectly. Moreover, this adverse corporate image will be detrimental to the future development of the foreign enterprise within the host country, and the influence may even extend to other countries.

**A STUDY ON US NATIONAL SECURITY REVIEW SYSTEM**

The national security review system plays an important role in safeguarding the economic security of the United States. It has been taken advantaged by the United States as a “safety valve” to encourage and attract foreign investment that is beneficial to its domestic economy, and to exclude and discourage foreign investment that is unfavorable to them.

**Relevant Legislation on US National Security Review System**

The United States is the first country in the world to establish the national security review system. It had relevant legislation on foreign investment review already as early as 1950s, such as the Defense Production Act 1950. In the late 1970s, especially in 1980s, the large number of acquisitions of American companies conducted by Japanese companies raised the attention of the government of the United States. To reduce the risk that might be brought to the national security of the United States by
foreign mergers and acquisitions (M&A), the United States Congress passed the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988, which established the early form of the national security review system for foreign investment. According to this Act, any mergers, acquisitions or takeovers of US person conducted by foreign person may be suspended or prohibited by the decision of the President, if the mergers, acquisitions or takeovers threatened to impair the national security of the United States. Later, the Congress passed the Byrd Amendment in 1993, which revised several provisions on the National Defense Authority Act. In case of the transactions subject to national security review, there were two more situations included, of which the transactions controlled by foreign government or on behalf of foreign government was emphasized particularly. The Foreign Investment and National Security Act (FINSA) was carried out in 2007, which aimed at clarifying the government’s authority and the process undertaken to ensure that cross-border M&As do not infringe on national security. It provided a rather specified and detailed regulation system for the conduct of national security review and confirmed the scope and the procedure of the review process. Thus, the United States has established a comprehensive national security review system, and strengthened the regulation and control over foreign investment. Subsequently, following the United States, a large number of countries have set up similar national security review systems, including Canada, Russia and China. These different review systems have all been influenced by the United States to some extent.

Main Contents of US National Security Review System

Generally, the national security review system consists of four aspects: the subjects of the national security review, the objects of the national security review, the criteria of the national security review and the procedure of the national security review. The national security review systems in most countries share similar principles and concepts, only have difference in specific rules. Since the formation of the national security review system in the United States has been the earliest, it has a strong demonstration effect to other countries around the world, which represents the general mode of national security review system.

THE SUBJECTS OF US NATIONAL SECURITY REVIEW

There are three subjects of the US national security review, namely, the Committee on Foreign Investment in the United States (CFIUS), the Congress and the President. CFIUS has the authority to review and investigate cross-border M&As and to negotiate, impose and enforce conditions to mitigate any threat to national security presented by any transaction. The main role of the Congress in the national security review system is to supervise the actions conducted by CFIUS. The President has the power to decide whether or not to stop a foreign acquisition transaction after the review process.

THE OBJECTS OF US NATIONAL SECURITY REVIEW

In general, the US national security review targets at foreign M&As that could harm the nation’s national security. The provision has changed many times as to what kind of transaction may endanger national security. Finally, according to FINSA 2007,
“any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States” should subject to national security review. This is the so-called “covered transaction”.

THE CRITERIA OF US NATIONAL SECURITY REVIEW

The key word of the criteria of the national security review is national security. In regard to the specific meaning of “national security”, CFIUS has not given a clear definition, but provided some factors that need to be considered instead. These 11 factors are as follows: (1) domestic production needed for projected national defense requirements. (2) The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services. (3) The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security. (4) The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country. (5) The potential effects of the proposed or pending transaction on United States international technological leadership in areas affecting United States national security. (6) The potential national security-related effects on United States critical infrastructure. (7) The potential national security-related effects on United States critical technologies. (8) Whether the covered transaction is a foreign government-controlled transaction. (9) As appropriate, and particularly with respect to transactions requiring an investigation, a review of the current assessment of: (A) the adherence of the subject country to nonproliferation control regimes; (B) the relationship of such country with the United States, specifically on its record on cooperating in counterterrorism efforts; (C) the potential for transshipment or diversion of technologies with military applications. (10) The long-term projection of United States requirements for sources of energy and other critical resources and material; and (11) such other factors as the President or the Committee may determine to be appropriate, generally or in connection with a specific review or investigation. Overall, the national security review process mainly focuses on the M&A transactions in connection with national defense security industry, critical technologies and state-owned enterprises that related to foreign government. In terms of the scope, the early national security review system mainly concerns military security. Nonetheless, in recent years, it has gradually paid more attention to economic security and political security. Meanwhile, the definition of national security has expanded.

THE PROCEDURE OF US NATIONAL SECURITY REVIEW

The national security review process is divided into three phases, namely, the procedure of review, the procedure of investigation and the decision of the President. The initiation of the procedure of review has two different types. One is based on the voluntary notification submitted by the investor of a proposed transaction, and the other is compulsory review process conducted by CFIUS itself. The former one indicates that the investor voluntarily reports its transaction to the CFIUS and subjects it to be reviewed while the latter refers to the compulsory scrutiny of the transaction by the censorship authority. With regard to the latter one, there are two situations to be
discussed. Firstly, as long as the CFIUS or the President considers that the transaction involved may endanger the national security of the United States and it also falls into the scope of “covered transactions”, a mandatory review may be instituted then. Secondly, if the investor of a transaction has provided any false or misleading information or omitted important information during the voluntary reporting procedure, the CFIUS may conduct a review process over the transaction again. Upon completion of the review process, if the covered transaction is considered to have the possibility to threaten to impair the national security of the United States, the investigation procedure starts then. During this period, the CFIUS will conduct an investigation over the proposed transaction on the basis of the 11 criteria provided in the FINSA and finally come up with an investigation report, approving or recommending termination of the M&A transaction. Upon completion of the review and investigation procedure, the President shall make a decision on whether to approve or prohibit the proposed transaction, in accordance with the opinions or recommendations of the CFIUS.

**US NATIONAL SECURITY REVIEW SYSTEM CONSTITUTES A POTENTIAL TOOL OF INVESTMENT PROTECTIONISM**

The national security review system is an important means for the state to exercise economic sovereignty and administrative functions, which plays an increasingly important role in maintaining national economic security and promoting the inflow of foreign investment. As for the host country, it is reasonable to strengthen the regulation and supervision of foreign investment. However, once such regulation exceeds reasonable limits, it may constitute discriminatory treatment of foreign investment and lead to investment protectionism, which is contrary to the idea of investment liberalization advocated in the field of international investment. Lately, in the United States, the scope of the national security review is expanding and the procedure of national security review is increasingly stringent. This developing trend mainly aims at restricting the operation of foreign investment, especially in the field of M&As. It coincides with the purpose of investment protectionism, which is intentionally preventing the inflow of foreign investment and safeguarding the domestic investment. In a word, the US national security review system has developed into a potential tool of investment protectionism.

**Restraining Foreign Investment through the Expansion of the Scope of the National Security Review**

The scope of the national security review, in short, mainly refers to foreign investment that threatens to impair the national security. The scope of the national security review was relatively narrow in early times, which only related to the field of military defense, critical infrastructure (such as nuclear industry, aerospace and other industries). Yet, in recent years, its scope has gradually extended to the energy industry, high-tech, and food processing and so forth. At the same time, the concept of early national security was generally limited to national defense and military security, but it has evolved into a comprehensive security concept which integrates economic security and political security currently. In the case of the United States, early in the mid-twentieth century, the United States has already noted the security issue of defense products, yet the real formation of the national security review system was
upon the publication of the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988. During this period, the influx of foreign capital from Japan caused a strong impact on American local industry, which raised the attention on national security issues of American government. In order to reduce the negative impacts of foreign capital inflows on the economy, the United States Congress approved the national security review system for foreign M&As through legislation. Around 1990s, due to the stimulus of a number of foreign M&As, the United States issued the “Byrd Amendment”. This Amendment aimed at strengthening the security review of foreign M&As, with emphasis on the review of the transactions controlled by foreign government or on behalf of the foreign government. The sensitivity to M&As involving foreign governments has resulted in the prohibition of a large number of transactions conducted by state-owned enterprises, and China has become the biggest victim. Affected by the “9·11” terrorist attacks, the United States has been more concerned about its own national security issues. In 2007, the United States passed the FINSA, which expanded the scope of the national security review and strengthened the review process.

In addition to the United States, Australia, Germany and some other countries have also gradually revised their foreign investment legislation, expanding the scope of foreign investment review, and limiting the entry of foreign investment. Generally, foreign investment review only refers to the review of foreign M&As. However, there are some different approaches. For instance, according to the legislation of Canada, national security review should be applied to both foreign M&As and establishment of foreign investment. China shares the same approach. In terms of this approach, the scope of the review process has been expanded severely, which implies that all the foreign investment behavior should be subject to national security review. In a certain sense, the regulation and control of foreign investment have been reinforced.

The expansion of the scope of national security review leads to the sharp increase in the number of the foreign investment behavior which subject to review. Therefore, the host country has greater power in deciding whether to approve or to prohibit foreign M&As. As for the United States, the percentage of the transactions to be reviewed rose from 1.6% in 2005 to 49.5% in 2013, the percentage of the withdrawals of transactions increased from 3.1% in 2005 to 8.2% in 2013. It is worth noting that in 2012 this number has accounted for 19.3%. According to the statistics, it is easy to conclude that due to the expansion of the scope of national security review, increasingly more foreign M&A transactions will have to be reviewed under CFIUS, which means that the success of a transaction will become far more difficult than before. As a consequence, national security review has been playing the role of hindering foreign investment gradually.

Furthermore, the scope of the concept of “national security” is also expanding. The Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988 stipulates 6 factors to be considered. Later, FINSA added the factors into 11, let alone the last one is a miscellaneous provision, which implies that except for the former 10 factors, the CFIUS may still initiate the review whenever it considers appropriate. Thus, the scope of the review seems to have no boundaries. Meanwhile, the obscurity of the concept of “national security” offers great discretion for the United States to decide whether an investment transaction has the possibility to impair its national security. It weakens the predictability of the result of a transaction review and increases the risk and uncertainty of foreign investment behavior. Additionally, since
the national security review system has not been incorporated into the exception clause of the bilateral and multilateral investment agreements of the United States, it may have the possibility of constituting a violation of the National Treatment for foreign investors, which is discriminatory. This reveals its essence as a potential tool of investment protectionism in a certain sense.

**Restraining Foreign Investment through the Increasing Strictness of the Procedure of the National Security Review**

The procedure of the national security review has undergone a process from leniency to strictness and become far more complex than before. The lengthy and complicated review procedure has increasingly evolved into a stumbling block for overseas investment. A large number of foreign investors may withdraw their M&A transactions before the initiation of investigation process. This results in the severe restraint of the enthusiasm of foreign investors and the global flow of foreign investment.

In the early national security review system of the United States, the procedure of review was relatively loose. The reason behind was that the United States was the biggest beneficiary of trade liberalization and investment liberalization. Maintaining a relatively loose trade and investment policy is of great benefit to the development of the American economy. As a result, the main purpose of the early US national security review system was to create a friendly investment environment. Nevertheless, after the “9·11” terrorist attacks, the United States has attached greater importance to national security issues. The scope of the concept of national security is increasingly expanding. The sensitivity to national security has penetrated into all walks of life. The national security review within the field of international investment has become stricter, and a number of investment issues have been politicized significantly. For example, the acquisition of the IBM PC unit by China’s Lenovo Inc and the attempted acquisition of Unocal Oil Company by CNOOC have all been subject to the US national security review and ultimately failed. The failing of these two transactions attributes to the acquirers’ close relationship to the Chinese government. It is noteworthy that transactions connected to foreign governments or on behalf of foreign governments are the most sensitive ones under the US national security review system. The close linkage between foreign governments and the national security of the United States implies the politicization of its national security review system. This is an important proof of the influence of investment protectionism.

The procedure of the national security review of the United States is quite complicated. As mentioned above, the initiation of the national security review process is divided into two categories, one is voluntary reporting and the other is compulsory review. Although the first one is based on the voluntariness of the foreign investors, this voluntariness is accepted passively. Because, if a proposed transaction is voluntarily submitted to be reviewed, it will not have to take the risk of being reviewed again in the future as long as the former review is approved by CFIUS (unless the investor of a transaction has provided any false or misleading information or omitted important information during the voluntary reporting procedure). On the contrary, if the proposed transaction has not been voluntarily submitted to be reviewed, once being found not in conformity with the conditions provided in relevant legislation by the CFIUS or the President, it may have to face the result of forced
termination and even being punished. Thus, almost all foreign M&A transactions have
to apply for review voluntarily. In addition, the time limit of national security review
also constitutes one of the reasons for the blockage of some foreign M&As. Normally,
a foreign M&A review process must be completed within 30 days, but if there are
situations which related to foreign governments or the acquirer of the proposed
transaction fails to reach an agreement with the CFIUS, then the review process may
be extended for 45 days. If CFIUS recommends action, the President has the final
power to make a decision within 15 days. Also, the final decision delivered by the
President is not allowed to appeal, which means that if the acquirer suffers injustice
during the national security review process, it has no access to obtaining relief. In fact,
after submitted to review procedure, a large number of M&A transactions have to be
withdrawn even before the announcement of the final review result on account of the
huge pressure came from American government and public opinions. This
phenomenon indicates that the investment protectionism is on the rise in the United
States. It takes advantage of the national security review system to hinder or prevent
any foreign investment that is harmful to the United States, even when the harm is
only potential or not worth mentioning.

The essence of investment protectionism is to limit the inflow of foreign
investment and weaken the competitiveness of foreign investment in the name of
protecting domestic economy. In terms of the recent development of the national
security review system of the United States, the scope of the review process is
expanding and the procedure is increasingly stringent. Actually, the authentic purpose
behind is to reinforce the government’s control over the operation of foreign
investment. It attempts to maximize its national interests through the control and the
regulation of foreign investment by means of national security review. Sometimes, the
so-called control and regulation may be conducted in a discriminatory manner. In
other words, investment protectionism has been practiced in the name of national
security review. Accordingly, such kind of national security review system has
ggradually become a tool of investment protectionism.

CONCLUSION

The establishment of the national security review system is an important
manifestation of the international investment protection. Restriction on foreign
investment in strategic industries is a common practice to protect the domestic
economic security of the host country around the world, which has been exercised as a
national economic sovereignty means. In regard to the industries connected with
national security or national welfare, for both developed countries and developing
countries, foreign investment is prohibited or restricted. As for the United States, the
national security review system has been playing the role of “safety valve” in early
times, which serves the function of regulating foreign investment and protecting
national economic security. Nevertheless, in recent years, the scope of the national
security review system has been expanding, and the procedure of the national security
review system has been increasingly strict. The threat of impairing national security
has been taken as an excuse to prevent the unfavorable foreign investment arbitrarily
through the national security review system. As a consequence, a large number of
foreign M&As have suffered restriction or even prohibition on account of the stringent
national security review system. Seemingly, the national security review system of the
United States has gradually evolved into a potential tool of investment protectionism. Currently, in the field of international investment, any intention of exercising investment protectionism is undesirable, even though it is in the disguise of national security review. The international community should have a clear and profound understanding of the phenomenon, and make an attempt to strike a balance between the development of foreign investment and the safeguard of domestic national security.

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