Gertz, Geoffrey. 2021. "Investment Screening before, during, and after COVID-19." *Global Perspectives* 2 (1). https://doi.org/10.1525/gp.2021.24538.

Political Economy, Markets, and Institutions

Investment Screening before, during, and after COVID-19

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Keywords: covid-19, foreign direct investment, national security, globalization, international political economy

https://doi.org/10.1525/gp.2021.24538

Global Perspectives

Vol. 2, Issue 1, 2021

In the wake of the COVID-19 pandemic, several states introduced and expanded regulatory frameworks for screening (and potentially blocking) inward foreign direct investment. This shift accelerated a preexisting trend in the global political economy, as states have been widening their understanding of "national security" risks arising from foreign investment. The result is that such screening mechanisms are evolving from a niche subject to a broader regulatory tool that touches an expanding share of global economic activity. The tensions inherent in this shift—including how firms will respond, how states can evaluate systemic (rather than transactional) risk, and the potential and limits of international cooperation in investment screening—have not yet been resolved.

In the late twentieth century, many states liberalized their investment policies, welcoming inward foreign direct investment (FDI). Once viewed as a threat, FDI instead increasingly came to be seen as promoting domestic development and validating states' economic policies and trajectories. The shift to liberal inward investment policies was tied to broader economic liberalization and reflected demand for capital from the domestic business sector (Bauerle Danzman 2019), democratization that strengthened the political influence of labor interests that benefitted from FDI (Pandya 2014), changing ideas among policymakers (Linsi 2020), and an international competitive dynamic among liberalizing states (Elkins, Guzman, and Simmons 2006).

More recently, however, states have been reassessing the possible threats arising from foreign investment. Even as states liberalized their inward FDI policies overall, policymakers still viewed *specific* types of investment—in strategically important industries or from political rival countries, for instance—as risky, and regulated and potentially blocked foreign acquisitions in these cases. What types of investment constitute "security risks" has always been a contested and socially constructed question, however. Today the understanding of security risks from FDI is expanding, implicating a broader range of cross-border transactions. In response to the COVID-19 pandemic, several states introduced or expanded policies for foreign investment screening, with a particular focus on the medical goods industry. The pandemic has prompted an acceleration of trends already underway in the years leading up to 2020, similar to dynamics observed in other fields discussed in this special collection.[1]

The shift toward more interventionist investment screening policies both reflects and anticipates two broader trends in the global political economy, and merits greater interest from international political economy (IPE) scholars.[2] First, it epitomizes states' increasing focus on the risks and vulnerabilities arising from economic integration (Farrell and Newman 2019; Walter 2021), which in turn has sparked greater demand for state autonomy in managing globalization (Moraes and Wigell 2020). States' experiences in reforming investment screening programs may inform their strategies on issues such as supply chains and data governance, where states are similarly seeking to preserve the gains from economic integration while minimizing the downside risks. Second, investment screening policies are a key arena for integrating economic and security modes of policy-making, and for defining the legitimacy of national security exceptions to economic integration (Heath 2020; Roberts, Moraes, and Ferguson 2019; Cohen 2020). Such exceptions have traditionally been rarely invoked but appear poised to become more common as the boundaries between economic and security concerns collapse.

RECENT TRENDS IN INVESTMENT SCREENING, BEFORE AND DURING THE COVID-19 PANDEMIC

States use investment screening regulatory frameworks to evaluate individual FDI transactions for risks and vulnera-

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1 See, in particular, the essays from Babic, Katz-Rosene, and Linsi in this collection.

2 There has been relatively little work within IPE on investment screening; important exceptions include Baltz (2017); Lenihan (2018); Ufimtseva (2020); Canes-Wrone, Mattioli, and Meunier (2020); and Bauerle Danzman (2021).

bilities related to national security, public order, public interest, or similar concerns. For instance, in 2006 the US government assessed the risks of UAE-owned Dubai Ports World's acquiring a company that operated six ports in the United States; the deal was initially approved but was subsequently abandoned in the face of political backlash. Similarly, the Australian government prevented Royal Dutch Shell from acquiring a controlling stake in Woodside, Australia's largest energy company, in 2001.

Such frameworks may be targeted to specific sectors or apply economy-wide. As a result of a national security screening, foreign investments can either be approved, be allowed to proceed subject to certain risk mitigation measures (such as agreeing to keep sensitive data stored domestically), or be outright blocked. While publicly available data are limited, it appears overall that only a small minority of assessed investments are ultimately blocked (UNCTAD 2019). Yet even for those investments ultimately approved, investment screening regulatory measures can introduce considerable costs (in both time and legal fees) and uncertainty, and thus can potentially deter would-be foreign investors.

Even before the COVID-19 pandemic, it was evident that many states were expanding their investment screening practices. The UN Conference on Trade and Development (UNCTAD) found that, between 2011 and 2019, at least thirteen countries introduced new regulatory frameworks for screening foreign investment for national security and other public purposes. Meanwhile, during the same period, there were forty-five instances of states amending their existing mechanisms; in thirty-six of these cases, screening measures were tightened and/or expanded, and in only nine instances were they made less stringent (UNCTAD 2019).

Two trends underlie this shift. The first is the rise of China as a geopolitical power and major capital exporter. Due to the close (and often opaque) links between Chinese companies and the Chinese state as well as China's assertive foreign policy, many states appear to be increasingly apprehensive about Chinese FDI (Gertz 2016). Of the twenty major foreign takeovers (USD 50 million or larger) UNCTAD identified that were blocked or abandoned due to national security concerns between 2016 and 2019, seventeen were from China (UNCTAD 2019). Growing reticence toward Chinese FDI presaged larger political debates on the merits of "decoupling" supply chains from China, which gained prominence in the aftermath of COVID-19.

The second is the broadening and blurring of the concept of "national security." Historically, screening mechanisms adopted a more narrowly defined understanding of national security, focused on sectors such as military goods and core energy and infrastructure networks. This approach allowed states to follow the "small yard with a high fence" principle: shielding only a very limited scope of investments, but with sharp delimits regulating any foreign activity in such sectors. Yet states have been amending their foreign investment screening frameworks to allow for a more expansive understanding of national security, encroaching into areas such as personal data, new technologies, mass media, and food security (OECD 2020a, 26-27). In the United States, the government substantially revised the legislation underpinning the Committee on Foreign Investment in the United States (CFIUS) in 2018 to include explicit focus on critical technology, critical infrastructure, and personal data. CFIUS has since warned of security risks from popular apps such as Grindr and TikTok, both of which collect extensive personal data from users. In Germany, following the controversial 2016 Chinese takeover of KUKA, a robotics firm, the government implemented a series of reforms to expand its screening procedures, in 2017, 2018, and 2020. Such shifts challenge the small yard–high fence paradigm of investment screening: as security risks touch an ever broader range of modern economic activity, states are grappling with just where, and how high, to erect their fences.

The pandemic further heightened states' concerns with risks arising from economic globalization. Instability in global supply chains sparked calls for greater self-sufficiency in critical industries, privileging the resilience—rather than the efficiency—of economic production networks (Linsi, this collection). A similar logic drove reevaluations of investment screening policies. In the first half of 2020, states introduced some forty-five new and reformed investment screening policies, a substantial acceleration of recent trends (OECD 2020b). Of these new policies, approximately a third were explicitly justified as a response to the pandemic (OECD 2020b). States' decisions to restrict FDI in the current crisis stands in stark contrast to their actions following the 2008 crisis, when many governments aggressively courted new investments.

Pandemic-related investment screening reforms fall into two groups. First, multiple states with sectoral approaches to investment screening added health-related industries to their list of critical sectors. The immediate strains on health systems and shortages in key health supply chains pushed governments to see health industries as critical infrastructure. In Europe, this shift was sparked in part by rumors that the Trump administration was seeking to acquire CureVac, a German biotech company involved in early research on a coronavirus vaccine (Hackenbroich 2020). German finance minister Peter Altmaier loudly announced that "Germany is not for sale" and went on to declare that "where important infrastructure and national and European interests are concerned, we will take action if we have to" (quoted in *Guardian* 2020). The European Commission put out guidance explicitly calling on member states to vigilantly screen FDI in health-care and related industries in order to safeguard resilient supply chains and ensure that any such FDI "does not have a harmful impact on the EU's capacity to cover the health needs of its citizens" (European European Commission 2020).

Second, several states also expanded new economy-wide investment screening policies, motivated at least in part by the worry that economic volatility and financial distress due to COVID-19 would temporarily depress the value of companies, making them appealing takeover targets (OECD 2020b). As the Organisation for Economic Co-operation and Development (OECD) noted, these actions reflect a new government discourse around the threat of "opportunistic acquisitions" and "predatory acquisitions," and worries about selling off critical technologies to foreign interests (OECD 2020b).

This heightened scrutiny has led to several investments being blocked throughout the pandemic. For instance, the

Australian government nixed the Chinese acquisition of food manufacturer Lion Dairy and Drinks in August 2020; three months later, the company was sold to the Australian food conglomerate Bega, for around USD 30 million less than the earlier Chinese bid. While Australian government officials would explain only that the Chinese deal was not in the "national interest," one commentator suggested that the local acquisition "plays well into Prime Minister Scott Morrison's post COVID desire for increased local food production" (Knight 2020). Similarly, in January 2021 the French government quashed a proposed Canadian acquisition of the supermarket chain Carrefour, citing the security of food supply chains as a key concern. As one analyst noted, "With the health crisis, there is a new doctrine emerging on foreign investment in France. More attention is being paid to ensure that France has supplies of key goods like medical equipment and food, and the proposed Carrefour deal does raise questions about sovereignty" (quoted in Abboud and Kirby 2021).

Overall, COVID-19 appears to have accelerated preexisting trends in investment screening. States were already increasingly worried about security risks arising from certain foreign investments, and were beginning to take a more active role in regulating inward FDI for a range of national security concerns. The pandemic led policymakers to further expand their definition of critical industries, with a focus on health systems. It also vividly demonstrated some of the vulnerabilities arising from global economic networks. As states aggressively pursued offensive economic statecraft—such as competing to acquire masks, vaccines, and other medical goods all over the world—other states responded by strengthening their defensive economic measures, including investment screening.

THE FUTURE OF INVESTMENT SCREENING

What can states' COVID-19-related policy reforms tell us about the longer-term outlook of investment screening? Here I briefly consider three key questions for the future of national security investment screening. How states resolve these tensions may be an important signal for broader efforts to reset globalization in the years ahead.

WILL BUSINESS PUSH BACK?

As long as investment screening remained limited to core national security industries, it attracted scant public attention and minimal resistance from business interests. As foreign investment screening practices expand to cover a broader scope of activities, however, predictably domestic political contestation over investment screening is increasing. In the United States, for instance, the Trump administration's decision to compel divestment of the Chinese app TikTok sparked a wide-ranging debate on whether the government was acting out of genuine national security concerns or disguised protectionism, another plank in the US-China trade war. Meanwhile, the Federation of German Industries (BDI) recently warned that aggressive investment screening could impinge on the country's open investment environment, declaring that "the competitiveness and innovative strength of German industry is based on the protection of private property and freedom of contract—not on state protection of certain technologies" (BDI 2020).

Yet it remains to be seen how strongly and effectively business interests will push back against increasingly aggressive investment screening practices. While business groups may advocate for screening processes with less onerous regulatory requirements, they might be reluctant to openly lobby against measures that are defended by other interest groups as necessary for national security. Meanwhile, whereas businesses may resist creeping securitization when it results in greater regulatory burdens and limits on access to foreign capital, these same businesses may welcome the subsidies and protection from foreign challengers that can accompany geoeconomic competition, complicating their advocacy stances and coalitions (Gertz and Evers 2020).

BEYOND A CASE-BY-CASE APPROACH TO RISK ASSESSMENT?

Investment screening practices are designed to assess individual transactions on a case-by-case basis, assessing the specific facts at hand to evaluate risks. Yet such a regulatory approach is arguably ill-suited to defending states' interests and security in a world of complex interdependence (Oatley 2019). That is, given the complexity of global production networks, governments should think about systemic risk rather than transactional risk.[3] It may be the case that, even when no individual FDI transaction in isolation presents a threat, a broader, holistic analysis of the totality of FDI in a critical industry would reveal worrying dependencies. States' willingness to weigh broader financial distress conditions associated with the pandemic in their investment screening practices is a recognition that factors beyond the immediate facts of an individual transaction can be relevant in assessing investment risks.

Moving away from a transactional approach to a more systemic approach is likely to be challenging, however, as states have developed their policy practices and procedures around evaluating individual investments on a case-by-case basis. It is already difficult enough for states to integrate the economic, foreign policy, and national security policymaking processes in order to assess investment risks; in the United States, for instance, CFIUS is an interagency process that involves nine core agency members and an additional five observer members. An investment screening process rooted in complexity rather than an evaluation of one-off, individual transactions would require significant changes to state practice.

3 This is analogous to the recent turn toward macroprudential regulation in financial markets, where regulators assess the stability of the financial system as a whole rather than the stability of individual institutions.

POTENTIAL AND LIMITS OF INTERNATIONAL COOPERATION

A final question is to what extent states, particularly allies, can agree on shared norms and practices in investment screening, allowing for greater international cooperation and regulation. At the moment, there is no particular international oversight or coordination of investment screening policies, and should states ever face challenges to their policies under existing international investment commitments, they would likely claim national security exceptions to avoid any obligations. Again, as long as investment screening remained limited to a narrow subset of industries, the absence of international discipline on screening policies did not present a serious challenge to the wider investment regime. But with broadening—and more contested—definitions of national security, the lack of any international cooperation to distinguish legitimate from illegitimate investment screening practices could become a growing problem. Though states are traditionally reluctant to delegate anything having to do with national security to international oversight, the trade regime is already beginning to grapple with whether and how such claims should be evaluated by third parties (Boklan and Bahri 2020). In both the United States and Europe, governments are increasingly discussing the merits of greater allied cooperation on issues related to technology competition and export controls, potentially creating an opening for cooperation on investment screening as well.

CONCLUSION

Throughout the COVID-19 pandemic, several states have introduced and expanded investment screening procedures, accelerating a trend that first emerged some five years ago. The reclassification of health sectors as a critical industry echoes a more general broadening of states' conceptions of "national security," which now frequently covers not only military-related production but also energy, infrastructure, data, technology, and telecommunications, among others.

Long a niche topic in IPE, investment screening appears likely to become an increasingly important tool for regulating the global economy. For scholars of IPE, meanwhile, there is a large and relatively unexplored research agenda on both the drivers and the effects of national security investment screening policies. Under what conditions do different security risks become salient to policymakers? What explains cross-national variation in screening frameworks? To what extent do screening frameworks deter broader foreign investment? Such questions are not only of academic and policy interest in their own right but also serve as a microcosm for larger debates on how states are rebalancing globalization.

COMPETING INTERESTS

The author has no competing interests to report.

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Submitted: January 28, 2021 PDT, Accepted: March 21, 2021 PDT

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