FDI & National Security: the Case of Critical Infrastructure Protection

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- FDI – The Growing Importance Globally
- FDI and CIP – A Potential Tension?
- FDI and CIP in the United States
- FDI and CIP in Israel
- Conclusion and Some Thoughts for Taking this Research Forward.

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General

- Tension between foreign direct investment (FDI) and national security is not new.
- The use of national security rationales to constrain FDI was always there.
- In some cases represented protectionism or similar ideology; in other cases genuine concerns to national security prohibited FDI.
- What has changed, then?
- Everything has broadened! Higher implications.

New Threats – New Targets

- An era of increased threat to national security.
- Change in the landscape of the global security environment, of what needs to be protected.
- Critical (Information) Infrastructures – have become lucrative targets – asymmetric warfare.
- ➔A national security issue.
- A *broadening* of the concept of national security.

FDI – The Growing Importance

- **The Washington Consensus** – adoption of the market economy as a superior economic institution (Williamson, 1993).
- Resulted in privatization and deregulation of essential products and services and removal of barriers to free trade and foreign ownership.
- CIs are put for sale and present great investment opportunities for foreign investors ➔ growing presence.

FDI – The Positive Effects

- **Positive effects on economies**(Graham & Marchick, 2006):
    - Domestic investment is insufficient to finance production and manufacturing;
    - Creates more jobs (also higher-paid);
    - Higher investment in R&D;
    - Positive effect on economic growth;
    - Higher productivity and product quality due to positive spillovers.
- Implications for **small market (developing) economies** – even greater effect.

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FDI and CIIP
A Potential Tension?

- Countries become more **dependent on inflow of money** (including investments by foreign governments) in order to keep privatization processes going.
- Countries become **more aware of the CIIP risk** (and probably more risk-averse). Homeland security at the forefront of their public policies (U.S. leading the way, others join).
- The change is in the broadening of the definition of national security (to include critical infrastructures) and the broadening of economic liberalization, privatization and deregulation.

FDI and CIIP
A Potential Tension?

- **Promulgation of policies** that address this tension (blanket restrictions; licensing provisions; trans-sectoral measures of review and approval – Dion & Gordon, 2008)).
- **Creation of higher barriers to FDI**, as well as broadening of what constitutes a threat to national security, and hence broader elements of the economy.

Israel and the U.S.

- Similarities:
  - Higher perceived threat – focus on national security.
  - Emphasis on CIIP.
  - Reliance on FDI.
- Differences:
  - Developed ≠ emerging market (Nitzan & Bichler, 2002).
  - Large ≠ small economy (Gal, 2003).
  - Who provides CIIP?

FDI and CIP in the United States

- The Exon-Florio Amendment and CFIUS.
- Traditionally, rarely restricted FDI (Treasury chairs).
- However – 9/11 (addition of DHS to CFIUS; procedures enabling the security community active participation).
- DWP controversy (2006).
- Ignited vast debate in Congress (also influenced by non-security related ideology).
- Numerous bills introduced (move chairmanship to DHS/DOD; demands for more national security focus; majority ownership of CIs).

FDI and CIP in the United States

- 2007 – the adoption of FINSA:
  - Introduction of CI and Homeland Security under the scope of review of CFIUS.
  - Shifting of the burden of proof to foreign investors that are government-owned/related.
  - CFIUS is authorized to unilaterally initiate inquiries.
- Followed by E.O. 13456 and Final Regulations:
  - Members may initiate inquiries.
  - Affirmed importance of CIP within national security.
  - Stronger enforcement mechanisms.

CFIUS Trends

Year	Number of Notices	Notices Withdrawn During Review	Number of Investigations	Notices Withdrawn During Investigations	Presidential Decisions
2005	55	1	1	1	0
2006	111	14	7	5	2
2007	138	10	6	5	0
2008	155	19	23	5	0
Total	459	44	37	16	2

CFIUS Trends

Year	Number of Notices	Number of Investigations	Number of Investigations – Number of Notices Ratio (%)
2005	55	1	1.8%
2006	111	7	6.3%
2007	138	6	4.34%
2008	155	23	14.8%
Total	459	37	8.06% (average)

FDI in the U.S. Post FINSA

- Data is preliminary, still too early to judge.
- There is an upward trend in the number of notices submitted, the number of notices withdrawn, and the number of investigations initiated by CFIUS following review.
- Notices submitted – perhaps the result of a growing understanding in the business and legal sectors.
- Notices withdrawn – understanding it may not go through – re-notifying after amending the transaction.
- Investigations – greater scrutiny in the review!

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FDI and CIP in Israel

- Liberalization and privatization since the 1990s.
- positive incentives to foreign investors (tax exemptions, subsidies); reducing trade barriers; cancellation of the central bank's intervention in foreign currencies.
- Privatization of CIs (previously government-owned).
- Security concerns effected through a series of laws, government decrees and executive orders.
- Ban on ownership higher than a certain threshold (cannot control and enjoy control premiums).
- Requirement for security clearance (BoD, officers, certain professionals).
- Bezeq and Bazan (Glencore).

FDI and CIP in Israel

- Results in potentially adverse economic effects (especially in small market economies):
  - limits the number of potential bidders in the privatization process (less competition, lower prices);
  - an already concentrated market becomes even more concentrated;
  - High opportunity costs (loss of the positive effects of FDI).

FDI and CIP in Israel

- Disregard to the potential adverse effects of the restrictions, especially in relation to privatizations:
  - Limits the number of potential bidders ➔ less competition ➔ lower prices.
  - High aggregate concentration of markets ➔ a limited number of participants ➔ even higher concentration.
  - High opportunity costs – foregoing the benefits of FDI.

Conclusion (and some thoughts re research)

- The new threat environment substantially affects FDI-related processes.
- The presumption that FDI contributes seems to be replaced by a presumption that it could threaten national security ➔ the threshold of what constitutes a risk to national security seems to have been lowered considerably.
- Stronger implications to small market/emerging economies – foregoing or outweighing the benefits of economic liberalization.

Conclusion (and some thoughts re research)

- Perhaps we want to deal with a small number of providers? Ex-ante competition for ex-post monopoly.
- Do transnational corporations indeed pose greater risks to national security than would local companies?
- How would this trend of stricter review of FDI affect foreign relations?
- Further empirical research required (also due to novel policies).

Questions?
Thank You!