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The G7 should cross-leverage antitrust and foreign investment screening policies

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In his latest quarterly IFLR National Security Column, Harry Broadman argues advanced economies' policies toward competition and national security should be mutually reinforcing

For decades, the G7 economies' policies toward foreign direct investment was one of the most open in the world. The raison d'être was twofold: to assure investors abroad their capital is welcome, since the global market for foreign investment is competitive; and because such investment can boost G7 economies' growth, create jobs for their citizens and stimulate innovation on their shores.

We veteran economic policymakers who focus on antitrust, foreign investment, national security and international technology flows fully understand these arguments. Indeed, inbound foreign direct investment can be seen as a "three-fer": providing a source of growth capital; introducing new ways of, and avenues for, commercially applying advances in scientific knowledge and technology; and stimulating competitive forces in the way in which our domestic market operates because of the entry of new businesses.

It's hardly a secret, however, that in the past two decades public policy by the G7 towards the potential national security impacts of foreign direct investment has been fundamentally altered, championed by the US with an embellished role Washington has ceded to the Committee on Foreign Investment in the U.S. (CFIUS) because of the passage of the Foreign Investment Risk Review Modernization Act ("FIRRMA") in 2018. Other G7 economies have followed suit.

But if the three legs of this stool were ever considered of equal importance—and there is no reason to believe that is always the case or that it should be—it's clear that the issues associated with salutary impacts on competition in the market as a result of entry by new foreign businesses, especially, though not only, those with certain technologies that can impact national security, seemingly have become less important.

Changing views on the competitive impacts of new entry by foreign firms

This shift has been driven in large part — though not exclusively — by the significant rise of China, whose Communist-led, state-dominated economy is second in size only to the US and has become the "world's factory".

In the case of the US, the result is that while foreign investment writ large is still welcome, it now depends more significantly than heretofore has been the case on what is the source country of such capital. The principle of foreign investment's competition-inducing effects is still acknowledged. But of equal, if not greater, significance in certain camps in Washington are the *potential* risks to national security the US may be exposed to from foreign investment originating from certain geographies. In essence, US policy now differentiates more than before that *all sources of foreign direct investment are not the same*.

Symbolic of this changing perspective is that while all Presidents in modern times have issued formal statements on US policy *welcoming* foreign investment—Biden did so in 2021—he also has issued several Executive Orders related to US *restrictions* on foreign investment on national security grounds, such as this one in 2023.

This stance is understandable. But US and other G7 policymakers, companies, and investors would do well to understand that the impacts of foreign direct investment on the national economy—whether from a national security or competition perspective—are neither static nor instantaneous. To fully gauge the benefits and costs, a dynamic framework that assesses these impacts over time is necessary.

We are now in a world where G7 pursuit of antitrust objectives through a policy of encouraging foreign direct investment is far more complex. On the one hand, public policy toward foreign direct investment increasingly must carefully balance significant tradeoffs: the potential benefits of greater competition with the heightened risks to national security.

On the other hand, the G7 has been moving in a direction where such tradeoffs are seen as illusory: that is, some policy makers judge the loss of competition itself as constituting a threat to national security. In part, this was the case in the US in the 1980s when Japan was in the sights of Washington because of Tokyo's stance vis a vis the country's electronic industry.

Today, however, the G7 is dealing with a far more combustible mixture: unlike Japan, a liberal democracy, China is neither liberal nor a democracy. The challenge now before US policy makers is thus how to deal with foreign direct investment from a country that is viewed as presenting a combination of threats to both US competition and national security.

Impacts on competition

It’s important to unbundle the effects of foreign direct investment on competition from those on national security. This requires a decision-making calculus that distinguishes between domestic entrants versus foreign entrants. As is the case with new domestic market participants, the impact on market competition from foreign direct investment depends on the mode of entry.

Foreign entrants that establish wholly new business operations are, with relatively few exceptions, pro-competitive. Investment from abroad, however, that takes the form of acquisition or merger of existing domestic firms could be competitively neutral—if it results solely in change of ownership—or serve to reduce competition—if the transaction reduces the number of independent suppliers or buyers.

Entry by Domestic Firms. Competition policy traditionally has taken a presumptive view that the entry of a new domestic seller or buyer into most product or service markets through greenfield investment is to be applauded. An important exception are markets that are generically characterised by large economies of scale and/or scope. In such sectors—such as utilities—entry and exit are generally subject to some form of government regulation. The competitive effects of greenfield entry by domestic firms are also assumed to include the stimulation of product or process innovation in the marketplace.

It is a wholly different matter when entry by a domestic entity is not de novo, but rather takes the form of such a party/parties acquiring or merging with established firms (since the number of independent sellers or buyers in the market would be effectively reduced). Whether the result is an increase in the exercise of monopoly or monopsony power and/or a forestalling of innovation — and thus an erosion of economic welfare by consumers or buyers — is a matter of evidence-based judgments.

Foreign Entrants. Assessing how entry by foreign firms affects the state of competition in a domestic market is more complex. It has long been a staple of empirical research by antitrust economists.

With the risk of making sweeping generalisations, the bulk of such research points to the fact that the intangible asset of “foreignness” does play a role — sometimes a significant one — in the nature and magnitude of these impacts.

As one would expect, if entry by foreign firms is pursued through merger or acquisition of existing domestic businesses, those firms tend to be more sensitive to being exposed to the risk or uncertainty of host nations using antitrust policies to impede or retard entry than are domestic firms largely regardless of the sector in question.

To state the obvious, on the margin, that dampens using that form of entry.

In contrast, in cases where foreign firms’ have pursued greenfield entry, historically challenges by domestic antitrust authorities are much less mixed. This is because host country policymakers, all other things equal, place greater value on foreign investments that entail generating new productive capacity and jobs in local markets.

In fact, *within* many G7 countries, individual jurisdictions may compete with one another to offer tax credits and other benefits to attract greenfield foreign investment.

Reconciling antitrust and national security impacts: the case of the US

Within the US, the policy tools at play assessing the economic welfare impacts of market entry matters were once the sole province of antitrust authorities — where the shades of "foreignness" were rarely decomposed based on nationality — that is no longer the case.

CFIUS introduced gauging the effects on US national security into the mix. Today, where foreign investments in the US are concerned, the public policy assessments of such transactions are a product of the interaction between antitrust and national security policies.

CFIUS is chaired by the Treasury Department and its standing members include the other principal agencies involved in international investment policy: Office of the US Trade Representative; Department of Commerce; Department of Defense; and State Department. Importantly, the Justice Department is also a CFIUS standing member. This means the top US federal Executive Branch line authority that oversees antitrust policy is present for CFIUS deliberations. While the Justice Department is a CFIUS member, the current legal authority under which CFIUS operates and makes judgments about national security, FIRRMA, does not explicitly specify assessing the impacts on competition in the U.S. economy.

By the same token, the statutes under which the Justice Department (and the Federal Trade Commission—Justice's sister antitrust enforcer but an independent agency) are authorised to make decisions on antitrust policy do not specify that consideration of national security impacts are to be considered in coming to those judgments.

Yet at the heart of both the US antitrust and national security regimes lies the criterion of "control." In the case of antitrust, the fundamental operative question turns on the extent to which an entity—by dint of its scale or other structural elements within the "relevant market"—has sufficient control to engage (or have engaged) in anticompetitive conduct. While this tends to mean firms of large market share are viewed as posing greater risk to competitive behavior, antitrust concerns also can be voiced for smaller firms.

With respect to CFIUS' judgements, control is considered in more expansive terms: its focus is primarily on the extent to which a prospective transaction (between a domestic and foreign entity(ies)) can function in such a way that elevates national security risks. In fact, under FIRRMA, even minority shareholders could be seen as having sufficient authority to cause such threats or conversely have enough rights to block actions that would otherwise forestall diminution of such threats.

For some, the conclusion that might be drawn from the foregoing is that the US regulatory framework governing the intersection of antitrust enforcement and national security policy needs to be overhauled. Given the Federal Government's penchant for creating entities or passing new laws, that's understandable.

As a former official in both the Executive and Legislative Branches, I'd resist the urge. While some clarifying amendments to existing statutes may be in order, and striking the proper balance can be tricky, Washington is not short on the requisite authority or professionals with deep expertise on the most salient issues currently at hand.

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