Research Note

The Big Screen: Mapping the Diffusion of Foreign Investment Screening Mechanisms[1]

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In the decade following the 2008 financial crisis, many advanced industrialized economies engaged in a competition to attract Foreign Direct Investment (FDI), whose flows had plummeted following the global shock. At the same time, however, they also implemented or tightened Investment Screening Mechanisms (ISMs), which empower governments to restrict foreign takeovers, especially in strategic sectors. ISMs are an understudied phenomenon in the International Political Economy literature. This research note describes patterns in the evolution of foreign investment screening policies and suggests a research agenda for analyzing these patterns. After defining ISMs and establishing the puzzle of rising investment screening in conjunction with rising efforts to attract FDI, we present a newly coded dataset on ISMs in OECD countries from 2007-2021, examining the evolution of seven key features of investment screening over time. Next, we set an agenda for future research by suggesting three explanations for their recent evolution in the shadow of rising Chinese investment: the role of bottom-up backlashes to economic globalization; elite-driven foreign policy arguments about the increasingly blurred lines between national and economic security in the information economy; and geopolitical transformations that have challenged key features of the post-war liberal order.

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In January 2021, the French government announced that it would block a Canadian company's planned acquisition of retail giant Carrefour, the largest employer in France.[2] Defending national food brands from foreign takeovers is not new in France. In 2005, in reaction to a rumored acquisition of French dairy company Danone by PepsiCo, the government created a mechanism to review inbound Foreign Direct Investment (FDI) (Lenihan 2018). Over the next fifteen years, France strengthened its investment review tool in successive steps, adding economic sectors and lowering thresholds covered by the review, leaving it well-equipped legally and institutionally to block the Carrefour takeover when it was announced. Politically, however, rejecting the deal was not an easy decision since the Canadian buyer had indicated that it planned to expand Carrefour's retail presence and invest 2.9 billion euros in the company.

The French government's decision to block this acquisition highlights a key puzzle of contemporary international political economy: since the inward flow of capital is generally good for economic growth, attracting foreign direct investment is often a priority for most countries, especially during periods of economic distress (Simmons 2014).[3] Yet even as global FDI flows plummeted after the 2008 global financial crisis, many advanced industrialized economies simultaneously implemented or tightened Investment Screening Mechanisms (ISMs), which empower governments to restrict foreign mergers and acquisitions (M&A), especially in strategic sectors.

Though part of a growing trend towards the securitization and geopoliticization of economic policy, ISMs are an understudied phenomenon in the International Political Economy literature. This research note begins to fill this gap by, first, describing patterns in the evolution of foreign investment screening policies and, second, suggesting a research agenda for analyzing these patterns.

We present a newly coded dataset on ISMs in OECD countries from 2007-2021, examining the evolution of seven key features of investment screening to answer basic descriptive questions about what investment screening regulations look like, how they compare across different country contexts, and how these mechanisms have changed over time. Next we ask what explains the proliferation and strengthening of FDI screening mechanisms in advanced economies over the past decade and set an agenda for future research by suggesting, but not testing, three explanations for their recent evolution: the role of bottom-up backlashes to economic globalization; elite-driven foreign policy arguments about the increasingly blurred lines between national and economic security in the information economy; and geopolitical transformations that have tested key features of the post-war liberal order. The expansion of investment screening powers challenges accepted wisdom about the role of state authority in the global economy, the ways in which governments compete with each other for mobile capital, and the role electoral politics plays in shaping orientations toward the global market.

[2] Giorgio Leali "France shields Carrefour from takeover in food security battle," *Politico.* 15 January, 2021. https://www.politico.eu/article/france-carrefour-takeover-food-security-battle/

[3] That governments and the public generally view FDI positively even during recession contrasts starkly with the politics of trade, which tends to generate increased calls for protectionist tariffs when countries experience hard times economically (Davis and Pelc 2017).

Foreign direct investment screening: History and practice

Investment screening is the practice of government reviewing of foreign investment transactions and denying entry to, or requiring the divestment of, investments that are deemed unacceptable. State regulators may evaluate FDI on a variety of criteria. Historically, investment screening usually happened on economic grounds: would the transaction generate a 'net economic benefit' to the host economy? Economic screens are restrictive toward FDI and the OECD FDI regulatory restrictiveness index penalizes states that screen investment for such net benefits (Kalinova, Palerm, and Thomsen 2010). By contrast, recent investment screening has been happening mostly on national security grounds: does a particular transaction have the potential to endanger national security?[4]

Investment screening regimes vary across time and space in many respects, including whether a country has a screening mechanism at all, what kinds of investments are covered, whether notification and review is mandatory and whether investment requires preauthorization to proceed, the criteria through which transactions are evaluated, and who within government reviews investments. What unites these disparate regulatory features as ones of investment screening is that, first, they are transaction-specific mechanisms for evaluating whether a government will allow a foreign investment in its jurisdiction and, second, they have some kind of routinized process through which investments are identified for review and scrutinized. Conceptualizing investment screening in this way allows for the possibility that review mechanisms may be: narrowly scoped to issues of genuine national security; economic tools to protect politically important domestic firms from foreign competition; tools to pressure foreign firms to structure investments in ways that are likely to transfer more technology and value-added activity to domestic subsidiaries; or flexible instruments that can achieve some combination of these objectives.

Investment screening, which can exist alongside an otherwise liberal investment regime, is distinct from other mechanisms of controlling inward investment. For instance, substantial state ownership in the economy can protect sensitive assets and sectors by reserving them for public ownership and by enacting 'golden share' arrangements conferring outsized voting rights to the state in strategic companies. Historically, another mechanism to control inward investment has been foreign equity restrictions that placed limits on foreign ownership of domestic firms or banned foreigners outright from sensitive sectors. Ownership limits are more restrictive than investment screening because they preclude any foreign investment in a controlled sector above the prescribed amount. In contrast, screening mechanisms seek to allow "acceptable" transactions while preventing entry of undesirable investors or the sale of specific sensitive assets to foreigners. While screening may be less restrictive, it is also more ambiguous and subject to interpretation than strict equity limits and, therefore, more susceptible to manipulation and even corruption (Lai 2021). Most countries substantially reduced their equity restrictions through the 1980s and 1990s, though lower- and middle- income countries were generally slower to do so (Pandya 2014). Through this period, many states also abandoned investment screening regimes that approved transactions on economic benefits grounds. As Mistura and Roulet observed in 2017, "While 30 years ago, about 70 percent of the OECD countries screened FDI projects, now fewer than one in six still do" (2017). Yet, the U.S., Canada, and Australia all retained investment screening regimes of varying scopes even as their broader investment environments became more liberal.

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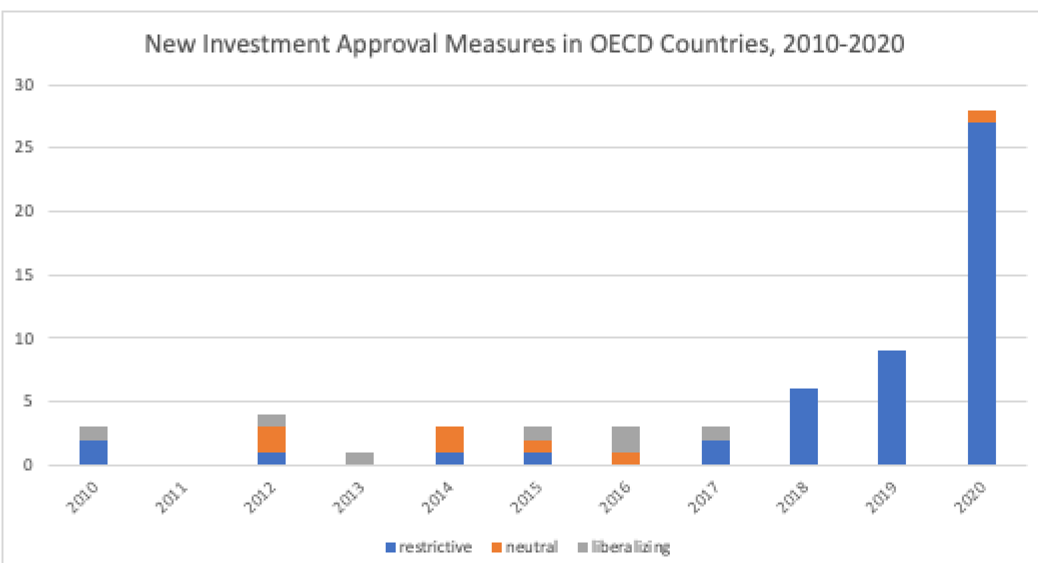
[4] In EU countries, the relevant screening concept is "public order" which is functionally equivalent to "national security."

As states liberalized their FDI policy environment, they generally dismantled formal investment screening regimes centered on economic benefits tests. Over the past three decades, FDI has usually been welcomed by host countries because it provides jobs and spillovers in know-how and technological innovation (Pandya 2016). In fact, countries, and localities, engage in fierce competition to attract investment through a variety of incentives and promotion efforts (Bauerle Danzman and Slaski 2021). Existing IPE theory explains these developments well, using work-horse factor proportion political economy models (Pandya 2014), partisanship (Pinto 2013), elite politics and financing concerns (Bauerle Danzman 2019), and neoliberal ideational networks (Linsi 2016).

However, as governments loosened their investment regulations, they also had to contend with the reality that certain investments carry potential perceived risks, notably for national security. In order to retain the benefits of foreign investment in an open economy while mitigating its threats and vulnerabilities, an increasing number of countries have, over time, developed procedures for screening foreign acquisitions and prohibiting transactions that are found to carry a degree of national security risk deemed unacceptable by authorities. The post-liberalization history of foreign direct investment screening practices in advanced economies is characterized by the slow, haphazard emergence of varied review mechanisms throughout the late 20th century, to be contrasted with a rapid acceleration and proliferation over the past decade. Figure 1, which uses data from UNCTAD's Investment Policy Monitor to track the number of new investment approval measures from 2010 to 2020 among OECD members, illustrates the increase of restrictive approval measures in recent years.

Figure 1: New investment approval measures have increased dramatically since 2017



Source: UNCTAD Investment Policy Monitor, measure disposition coded by authors, measures deemed automatic or reports of an investment approval or prohibition removed.

Regulations for the screening of foreign direct investment have been arguably most developed, and for the longest time, in the United States, which may seem paradoxical given the openness of the American economy and the prevalence of neoliberal, anti-statist ideology. The first wave of FDI screening in the US occurred during the oil crisis of the 1970s, prompted by investments from Middle Eastern countries. In 1975 President Ford created the Committee on Foreign Investment in the United States (CFIUS), an interagency committee designed to oversee the national security implications of foreign investment in the United States (Jackson 2020). The surge of Japanese investments in the United States in the 1980s prompted the next wave of investment screening (Milhaupt 2009). The 1988 Exon-Florio amendment (50 USC App. § 2170) authorized the president to 'investigate foreign acquisitions, mergers, and takeovers of, or investments in, US companies from a national security perspective'. President Reagan in turn delegated this authority to CFIUS.

Congress has considerably strengthened CFIUS's power to screen foreign investment transactions in the 21st century. Several post-9/11 high profile foreign acquisitions prompted the expansion of CFIUS' mandate to include a broader range of national security risks with the 2007 Foreign Investment and National Security Act (FINSA) (P.L. 110-49) (Jackson 2020) and the 2018 Foreign Investment Risk Review Modernization Act (FIRRMA).

Other countries have created their own investment screening mechanisms in recent years. In Europe, some of the more robust frameworks have been developed in Germany (since 2004) and France (since 2006). Both countries have widened the scope of transactions potentially subject to review and added new industrial sectors during the COVID-19 pandemic. In early 2021, the UK parliament passed the National Security and Investment Bill, which develops a separate legal framework for investment screening and creates the Investment Security Unit (ISU) to review transactions (Blanquart and Whitten 2021). In parallel to these national efforts, the European Union (EU) adopted in March 2019 its first investment screening framework, which became operational in October 2020.[5] Though not an independent screening mechanism at the European level, it provides the first collective framework for exchanging information and raising concerns about specific transactions in other EU member states (Chan and Meunier 2021).

Outside of Europe and the US, some of the most developed investment screening mechanisms are found in Australia, whose Foreign Investment Review Board (FIRB) has been screening investments since 1975, and Canada, which began FDI screening with the 1985 Investment Canada Act (ICA).[6] Amidst the pandemic, both countries expanded the scope of review and lowered the thresholds.

The puzzle of investment screening: ISMs in the literature

The recent proliferation and tightening of investment screening is puzzling because FDI is usually seen as positive for economic growth, technological development, and labor (Pandya 2016). Skilled workers whose incomes are more likely to increase with FDI tend to support liberal policies toward foreign investment (Pandya 2014). While small and less productive firms are often hurt by inward FDI (Alfaro and Chen 2018),

[5] European Parliament and Council of the European Union. (2019). Regulation (EU) 2019/452 of the European parliament and of the council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the union. *Official Journal of the European Union*, no. LI 79: 1–14. http://data.europa.eu/eli/reg/2019/452/oj.
[6] https://www.legislation.gov.au/Details/C2020C0002

large domestic business groups often support openness, especially toward M&As, to overcome financing constraints (Bauerle Danzman 2019). Policymakers have been keen to reduce restrictions on FDI in recognition of the potential benefits of opening up to foreign investment, including knowledge transfer, technological spillovers, and tax revenue (Kobrin 2005). Careful economic analysis has worked to precisely measure the size and effect of these vertical and horizontal positive spillovers (Javorcik 2004; Irsova and Havranek 2013). While some econometric analyses caution that FDI can have mixed and even negative effects on low-income countries (Karabay 2010; Li and Liu 2005), the ideational networks that elites inhabit have proliferated neoliberal doctrine and affinities toward liberalization throughout policy circles (Linsi 2016). Indeed, countries increasingly compete to attract FDI through active policies of promotions and incentives (Bauerle Danzman and Slaski 2021; Jensen and Malesky 2018).

Not only are the reconstruction of inward investment restrictions puzzling outright, but the precise timing of this wave of increased screening is surprisingly occurring at a time of global economic weakness. Previous research has demonstrated that governments are most likely to embrace inward FDI during economic downturns for their stimulative effect and employment support (Meunier 2014; Simmons 2014)and less likely to pursue protectionist economic measures during global upheaval (Davis and Pelc 2017). Yet, enhanced investment screening has occurred alongside the 2008 financial crisis and the economic disruption caused by the global COVID pandemic. Mirroring these crises, FDI plummeted in 2008 and made a slow and incomplete recovery before plummeting to below 2000 levels in 2020 (UNCTAD 2021).

By contrast to the abundant literature on the costs and benefits of hosting FDI, the literature on investment screening is scarce and embryonic. Until recently, screening regimes were rare enough that they likely did not substantially alter patterns of investment flow and ownership networks. This may explain why screening mechanisms were often overlooked by scholars and business interests alike. Today, however, investment screening is no longer a small carve-out that affects only a tiny portion of the economy. The concept of national security that forms the basis of most contemporary review mechanisms has expanded beyond the defense industrial base to include critical infrastructure, sensitive personal data, and a growing list of emerging and dual-use technologies.

As investment screening covers an expanding list of sectors, business activities, and assets, IPE theory needs clearer concepts and theories to explain the rise, use, and effects of these regulatory mechanisms. These developments are not well explained by traditional IPE frameworks. While there is little scholarship on national security-based investment screening, existing research explains the US experience with investment screening as a neoliberal tactic to contain and restrain protectionist and labor interests (Kang 1997; Baltz 2017). Some go further to argue that investment screening mechanisms such as the 2018 E.U. directive are offensive attempts to create bargaining leverage in negotiations to liberalize the investment environments in other countries (Schill 2019). Other research associated with investment protections and foreign policy formation more broadly emphasize public support for policies of negative reciprocity (Chilton, Milner, and Tingley 2020) and the ways in which domestic interest groups make economic statecraft challenging and push presidents toward military solutions (Milner and Tingley 2016).

These works are important and useful in their own right, but current investment screening politics demand new explanations. The growing assertiveness and reach of investment screening in the US and other high-income economies today suggests these regulations are more than small capitulations to isolationist groups. Additionally, investment screening mechanisms usually apply widely to foreign investment of any origin rather than narrowly to select countries with less open FDI regimes. While corporate interests often successfully block other actions of economic statecraft, support for more recent investment screening laws has been largely bi-and multi-partisan (Canes-Wrone, Mattioli, and Meunier 2020; Chan and Meunier 2021). Given that investment screening clearly imposes short-term material costs on global business by adding regulatory burden, increasing uncertainty over M&A prospects, and sometimes scuttling proposed deals, the absence of a powerful counter-lobby to these rules is puzzling. Several core concepts of investment screening - especially national security and acceptable risk - make the recent lack of strident opposition to these measures even more surprising because these nebulous terms render screening mechanisms vulnerable to perceived and real overuse for economic protectionist objectives.

Thus, the politics of investment screening does not seem well explained by the traditional IPE models that emphasize factor-based interest groups or those that see regulatory politics as a battle between exporters and importers or larger firms versus small firms or partisan acrimony. Both public discussion and recent academic literature on ISMs and related phenomena have focused mostly on investment screening as a tool of economic statecraft and military dominance in response to the growing prevalence of Chinese outward investment (Dimitropoulos 2020; Lai 2021; Lenihan 2018; Raess 2020; Chan and Meunier 2021) or as narrowly scoped mechanisms that deal solely with national security concerns while taking care not to depress flows of benign investment (Wehrlé and Pohl 2016).

These explanations are clearly part of the story - the rise of investment screening mechanisms in OECD countries is clearly associated with the rise of Chinese investment into these economies. And yet, the possibility of competing interests - whether they be the public, workers, firms, bureaucrats, or politicians - is curiously absent from much of developing literature on investment review. This is problematic because screening - even for national security - is likely to exact economic and institutional costs on countries that erect them. Screening can encourage rent-seeking by local firms and generates administrative burdens and regulatory uncertainty that raise the cost of investment (Mistura and Roulet 2019). Some scholars have examined how commercial interests may shape politicians' support for increased FDI screening (Graham and Marchick 2007; Frye and Pinto 2009; Canes-Wrone, Mattioli, and Meunier 2020). Yet, most of this research looks only at the US case and focuses on the threats associated with Chinese investment, even though some recent high-profile cases of investment prohibitions do not involve Chinese acquirers. More scholarship devoted to understanding how commercial actors' policy preferences are reflected (or not) in ISMs is important not only for making sense of the rapid expansion of such instruments, but also to generate new insights into the broader phenomenon of the increasing instrumentalization and securitization of economic exchange and the role global commercial actors play in this rapidly transforming global political economy.

Patterns of investment screening: An original measure

The first step towards this new theorizing is better data on the investment screening mechanisms themselves. We build a comprehensive dataset on screening laws in OECD countries, including qualitative coding across a range of characteristics (see appendix).

Despite the growing use of investment screening mechanisms, we are unaware of any existing dataset that provides time-series cross-sectional data mapping the content of investment screening regulations across space and time. The OECD's FDI regulatory restrictiveness index, perhaps the most comprehensive detailed measure of FDI regulation, has a dimension for "screening and approval requirements" but carves out, and therefore does not measure, national security review, which is at the core of contemporary investment screening (Kalinova, Palerm, and Thomsen 2010, 11). UNCTAD's investment policy monitor tracks newly implemented FDI-related regulations of numerous kinds and has identified 237 policy changes related to "approval and admission" from 2010 to January 2021.[7] However, the dataset does not code the substantive effects of the regulatory changes, nor does it provide any analysis of the legal details of countries' screening mechanisms. Members of the OECD's Freedom of Investment Roundtable are required to notify the OECD of any regulatory changes that could affect national treatment of foreign investment , so changes to investment screening authorities are reported in lengthy narrative documents but are not coded in a manner to facilitate analysis of trends or compare components of investment review mechanisms across countries.[8] As ISMs have proliferated, so too have tony law firms specializing in representing clients through the review process. These firms also publish trade reports that overview recent major changes to screening processes, again in narrative form. The World Bank has published a tracker of investment screening rules that are currently being considered or have been passed in the context of COVID, but this tracker has limited content mapping.[9] Another resource on COVID-related policies affecting investment provides narrative descriptions of changes, but does not arrange data in a way that facilitates comparison.[10]

IPE scholars need a comprehensive dataset that maps investment screening regulations context over time to answer basic descriptive questions about what investment screening regulations look like, how they compare across different country contexts, and how these mechanisms have changed over time. As economic policy in high income economies and emerging powers is increasingly organized around security concerns, investment screening is rapidly becoming a prominent feature of the global economy and can no longer be relegated to the error term. The OECD estimates that as much as 60 percent of global FDI flows are now potentially subject to national security related review under a cross sectoral mechanism (OECD 2020, 15).

We construct such a dataset for all 38 OECD countries from 2007-2021. We begin in 2007 as it likely represents the high watermark of neoliberal economic integration before the 2008 financial crisis, the euro crisis, and the rise of China as a major foreign investor. We focus on OECD countries because they are advanced economies that - as a condition of entry - commit to pursuing broadly liberal economic policies and therefore are least likely to use investment screening for economic protectionist objectives. We do not include China in the dataset because the history and political economy of investment regulation in the PRC is fundamentally distinct from those of market-based democracies.[11] Another benefit of restricting our dataset to OECD countries is the transparency of investment-related regulations and availability of primary sources

[7] https://investmentpolicy.unctad.org/investment-policy-monitor accessed 1 February 2021.
[8] See http://www.oecd.org/investment/g20.htm#foi
[9] https://dataviz.worldbank.org/views/FDI-COVID19/Overview?%3Aembed=y&%3AisGuestRedirectFromVizportal=y&%3Adisplay_count=n&%3AshowAppBanner=false&%3Aorigin=viz_share_link&%3AshowVizHome=n
[10] https://investmentmonitor.ai/resources/the-rise-of-protectionist-fdi-regulations
[11] All OECD countries have democratic histories, though they are not immune to recent global trends in democratic backsliding.

to code. We use publicly available OECD documents on FDI-related regulations, and especially the May 2020 OECD report on policies relating to essential security interests, as the base of our comprehensive coding of investment screening authorities. We then supplement these data with a variety of other sources including the UNCTAD Investment Policy Monitor, the U.S. State Department's Investment Climate Statements, the World Bank FDI Entry and Screening Tracker, Investment Monitor's FDI regulations database, and government websites.

We code countries as having an investment screening mechanism if (1) there is some sort of legal mechanism in place to approve or deny an investment in a host country business, (2) that mechanism has a clear and routinized process through which to exercise its authority. In most cases, it is relatively straightforward and uncontroversial whether an investment screening mechanism exists in a country. For instance, Australia clearly has a screening board (the Foreign Investment Review Board or FIRB) while Switzerland considered and declined to implement a screening mechanism in 2019.

In other cases, determining what "counts" as a screening mechanism requires an exercise of judgement. Iceland, for example, prohibits FDI from foreign state-owned enterprises unless specifically authorized by the Minister of Tourism, Industry, and Innovation (originally Commerce). The same minister may also block an investment on national security or public health grounds and/or compel a divestment for similar reasons. But there is no clear, routinized legal process through which review occurs, so we do not code Iceland as having an investment screening mechanism.

We build our dataset to include any type of investment screening mechanism, regardless of rationale, to have a more complete understanding of the regulatory contours of contemporary investment screening mechanisms. While many screening authorities are scoped around national security, not all are, and some countries empower review boards to evaluate proposed investments on the basis of multiple rationale. For instance, Mexico does not have a mechanism that reviews foreign investment for national security concerns. However, it does have a mandatory general screening requirement for both greenfield and acquisition-based FDI for majority investments if investments exceed a certain threshold or for investment of any amount in a few key (non-national security-related) sectors. Investors from certain countries in North and Latin America are exempted from seeking approval, but we code the existence of the screening requirement rather than its exemptions. While many screening authorities are scoped around national security, not all are, and some countries empower review boards to evaluate proposed investments on the basis of multiple rationale.

We focus our qualitative coding of each mechanism around the following seven concepts:

1. Scope - what kinds of sectors and business activities are subject to review?
2. Thresholds - how large of a stake and how large must the transaction be to trigger review?
3. Foreign Government Control - does the mechanism treat entities considered to be controlled by a foreign government differently than other foreign entities, and if so, how?
4. Net Benefit Tests - does the mechanism provide for review criteria that goes beyond national security/essential security concepts to more general economic policy concerns?
5. Pre-Approval - does the mechanism require pre-authorization and, if so, for all transactions or just a subset?

6. Monitoring/Enforcement - is the government empowered to monitor and enforce the mechanisms rules? In particular, can the government fine entities for non-compliance?
7. Screening Apparatus - who within the government (i.e. an inter-agency process or a particular agency) is tasked with transaction review? In particular, how influential are security-related agencies versus economy and commerce-related agencies?

Below we summarize four key insights from the dataset. Our code book is available in the manuscript's appendix, as is a summary table of documented changes to ISMs since 2007.

Observation One - Increased Implementation of National Security-Related Investment Screening

First, our data show a marked increase in the passage of investment review mechanisms and updates to existing laws in recent years. These new mechanisms are almost universally based on national security. Among newer and updated mechanisms, some continue to have net benefits tests, which add economic elements to the screening regime, but new screening tools unrelated to national security concerns are exceedingly rare. While governments have enacted investment review-related measures at an increased rate since the onset of COVID, this represents an acceleration of a trend rather than a major shift. A renewed interest in investment screening seems to be concurrent with a substantial increase in Chinese outward FDI into developed economies, which peaked in 2015-16. The increase in screening mechanisms does not register with the OECD's FDI Regulatory Restrictiveness Index, which is an indication that most of these new authorities are limited to national security concerns.

Observation Two - Broadening Scope of Sector Coverage

Second, the data show that investment screening mechanisms have increased their scope of coverage over time. This happens through two channels. First, there is a growing preference for cross-sectoral screening instruments, which provide governments with review authority over foreign investments regardless of sector. Governments often defend broad screening authority as an important mechanism for adequately confronting national security risks that change over time. While initial national security-related concerns over FDI were narrowly focused on foreign influence in defense contracts, governments' beliefs about what kinds of investment could impair national security have expanded into critical physical infrastructure, food security, data security, and dual-use technology. A cross-sectoral review mechanism allows governments broad coverage so that it is not necessary to update sectoral lists as views about what sectors may generate risks evolve. Indeed, some countries prefer cross-sectoral review because this allows them to leave the definition of national security quite vague.

Moreover, some countries continue to screen transactions only in specific sectors, but they have expanded the number of sectors subject to review over time. In 2007, the average country with a sector-specific ISM screened just under four sectors. In 2021, this average increased to 10 sectors. Emerging technology, critical infrastructure, and healthcare-related industries account for much of the increase in sectors covered.

Observation Three - Lower Review Thresholds

Third, our data indicate that investment review mechanisms cover increasingly smaller transactions, measured both in terms of absolute valuation and as a percentage of deal size. Because it is unrealistic to screen every transaction without severely restricting economic growth, review mechanisms have to determine how to separate "benign" investment from transactions that may generate concern. One way to do this is through sectoral screens. Another approach is to place value and interest-based thresholds on transaction coverage.

While most countries consider FDI to be investments above a ten percent threshold for balance of payments reporting purposes, this definition does not always translate directly into screening thresholds. Many governments set screening thresholds at a specific economic interest percentage of a business or asset, and may also place an additional coverage test related to the size of the investment (with larger investments being covered while small investments are not). The U.S. has always been focused instead on the concept of "control," and does not set an economic interest threshold but instead reviews each transaction to determine if the transaction is structured in a way in which the foreign person could obtain control through governance rights. In general, we see that governments are increasingly lowering both economic ownership and transaction size thresholds. We also see more mechanisms requiring mandatory filing requirements over time.

Observation Four - Some Policy Convergence

Finally, our data map a growing similarity over time among mechanisms passed. Though investment review mechanisms have been marked, even recently, by a general lack of convergence toward a single standard (Pohl and Rosselot 2020, 11), we see evidence that investment review authorities among OECD members are becoming more similar, especially in the wake of COVID. For example, more countries are requiring a larger set of mandatory, pre-closing reviews. We attribute this increase in policy similarity to the fact that bureaucrats in many governments had already begun considering enhanced approaches to investment screening prior to COVID. The crisis gave these policy entrepreneurs an opening to push through screening because the prior development of "off the shelf" solutions made it possible to offer investment review as a quick response to the economic and security concerns COVID instantiated.

Understanding the proliferation and strengthening of investment screening: a research agenda

In the remainder of this paper, we propose a research agenda for studying the evolution of investment screening mechanisms and their effects. We lay out several explanations for the recent proliferation and strengthening of investment screening mechanisms around the world, as well as for their differential design, and we suggest how some of these explanations could be tested, but we leave the actual testing for further research.

Globalization Backlash, Mass Politics, and the Rise of Economic Patriotism

First, scholars could borrow from the growing literature on mass politics and the backlash to international trade to investigate whether, when, and how public opinion influences investment screening politics. On one hand, public opinion may favor enhanced screening of inward investments in high income economies for several reasons. While much of the IPE literature focuses on the labor effects of FDI in developing country contexts, FDI into advanced economies can exacerbate income inequality and increase volatility in labor markets (Scheve and Slaughter 2004). Low-skilled workers who are more likely to be adversely affected by FDI tend to support restrictions on foreign investment and may leverage unionized power to maintain or impose such restrictions (Owen 2015). At the same time, investment screening is tightening even in contexts where labor organizing is weak. Ordinary citizens may be particularly wary of investments from perceived adversaries of the homeland; survey experimental research has shown public antipathy toward Chinese investment in the U.S. context (Chilton, Milner, and Tingley 2020).

While citizens may hold generally negative views of certain types of foreign investment, there are also reasons to be skeptical that mass politics drives investment screening. Screening regulations are generally obscure and highly technical. Do politicians benefit electorally from tighter investment screening, especially since decisions are taken secretly? How do more stringent screening regimes interact with investment promotion activities that governments often undertake to shape local economies (Bauerle Danzman and Slaski 2021) and claim credit for employment creation (Jensen and Malesky 2018)?

Scholars can use our ISM dataset to test more fine-grained expectations about public opinion over these screening mechanisms, and to better determine the circumstances under which these regulatory battles are likely salient to voters. Doing so can shed light on the more general phenomenon of how citizens think about the tradeoffs between protectionist economic stances - whether for national security or economic competitiveness - and concrete economic opportunities. Scholars can also use our disaggregated ISM database to tie public opinion surveys and experiments to sector-specific restrictions. As with other aspects of economic policy, preferences may vary across sectors. For instance, workers in technology-intensive industries may be highly concerned about technology-seeking foreign acquisitions, while workers in a greenfield logistics operation may welcome the new opportunities provided by foreign investment. Moreover, the temporal nature of our dataset can help researchers investigate when and how national security frames to economic policy become politically salient and how citizens think about the tension between economic growth and national security.

Capital Interests and the Blurring of Economic Competitiveness and National Security

Second, the politics of investment screening mechanisms provides a particularly rich opportunity to investigate how, when, and to what extent business interests are represented in policymaking as geoeconomic competition is challenging key features of an international liberal order (Roberts, Choer Moraes, and Ferguson 2019). We see three related areas of inquiry that can be particularly generative. First, investment screening is a site of contention for what national security means in an economic context (Cohen 2020; Farrell and Newman 2019). The ISM database can facilitate further analysis of the evolution of, and disagreement over, conceptualizations of what kinds of investments generate national security risks because it provides detailed information about the timing of procedural changes and scope of sectoral coverage over time.

Second, national security-oriented investment screening wrestles with the potential for dual-use of most emerging technologies. In what ways, and to what effect, are governments and international bodies distinguishing between technology and data that is too sensitive to share versus assets that are benign enough to trade? This line of inquiry has broader implications for the literature on the growing politicization of trade and investment policy (Meunier and Nicolaidis 2019) and the belief that complex networks of exchange have allowed actors to weaponize interdependence (Farrell and Newman 2019; Drezner, Farrell, and Newman 2021).

Finally, as the lines blur between defense-oriented and commercial technologies and more governments work to regulate ownership and production networks, how do business groups form policy preferences and how are these preferences reflected in policy? While the IPE literature provides many insights into the ways in which interest groups influence economic policy, the seeming absence of interest group politics from emerging stories about investment screening narrowly, and more assertive geoeconomic policies broadly, is puzzling. Why do business groups seem to not be influential in the policy-making process around these issues? Under what institutional conditions is it more likely that their preferences are integrated into laws and regulation? These questions speak to a fundamental rethinking of balance of power and authority between state and firms in the contemporary political economy; while IPE scholars have continually grappled with the diminution of state power under globalization, the return of regulatory assertiveness around investment screening may portend a reversion toward a more assertive state. Here, the variations in mechanism design catalogued in the ISM dataset may be helpful in analyzing which industries are more closely scrutinized and which jurisdictions choose laxer regimes.

Geopolitical Transformations and the Rise of China

Third, even though the emergence of a new source of foreign investment has historically been regarded by host countries with apprehension, when not downright hostility, there is little IPE literature on the politics of reacting to shifts in the geographical composition of inward investments. Yet as the history of investment screening in the US instantiates, each successive institutional innovation in the CFIUS process happened in response to the emergence of a new foreign investor: the OPEP countries in the 1970s, Japan in the 1980s, China in the 2000s. Indeed, the rise of China as a foreign investor, reflecting the broader rise of China in geopolitics, has coincided with the proliferation and tightening of ISMs worldwide in recent years, though few of these screening mechanisms are overtly discriminatory towards any particular country.

Some reasons why novel sources of foreign investment are interpreted as threatening and may prompt changes to investment screening procedures are generalizable across historical cases. For one, people in host countries are often suspicious of new foreign actors, which is consistent with the long-held concepts in the management literature about the 'liability of foreignness' and the 'costs of doing business abroad' (Zaheer 1995). Second, new sources of foreign investment may be feared more if the institutional and cultural distance between host and home country is large. Third, novelty seems especially threatening when the change is happening fast, as has been the case with Japanese investment in the 1980s and Chinese investment in the 2010s. Fourth, the geographical and sectoral ubiquity of investments coming from the new investor may prompt suspicion: the surge of Chinese investments in many sectors and many countries in the early 2010s may have aroused particular worries in many host countries. Scholars could probe the existence of an FDI novelty curve: does the fear and scrutiny of foreign investments dissipate as more transactions take place and become normalized in the host country? Could it be that initial investments from a new entrant are met with no particular reaction at first, then as more investments pour in media and politicians put the spotlight on this new phenomenon and the fears snowball into new ISM legislation, and then as more investment takes place fears go away and the nationality of the investor becomes a non-issue? Is there a certain time or volume threshold of investments beyond which fears plummet?

On the other hand, investments from China may have prompted increased screening measures in host countries because of the perception that there is something inherently different about the nature of Chinese FDI and therefore it should not be treated politically like any other foreign investment. Chinese investment indeed has unique characteristics that are not shared by investment from South Korea, the Netherlands, or Qatar, for instance. As Meunier (2019) has argued, some of these characteristics include: an emerging economy in need of high technology; a unique political system with state management of the economy, lack of transparency on the nature of investors, and blurring of lines between economic and political objectives; and a non-ally in the security dimension with geopolitical ambitions.

We suggest that more scholarship is needed to probe historically why investment screening measures are taken in reaction to new entrants but not others. Scholars could conduct comparative studies of threat perceptions of foreign investment coming from different countries in order to understand why some investors prompt a tightening of investment screening while others do not. In particular, such studies could examine the perception versus the reality of sources of investment in various countries and analyze whether ISM policies are made in response to actual or perceived percentages of inward FDI, for instance through media content analysis and survey research. Because domestic screening regimes have extraterritorial reach by constraining M&As of MNEs headquartered in foreign jurisdictions, the proliferation of ISMs should also be understood and studied as an example of policy diffusion. As key economies – namely the United States, the EU, and China – compete to set global regulatory standards around a range of economic activities, modeling ISM proliferation can help scholars test hypotheses about what kinds of economic and political levers translate into the power to shape others' legal environments.

Conclusion

This paper introduced a new comprehensive dataset of investment screening mechanisms in OECD countries, including qualitative coding across a range of characteristics. Some of the key insights from the data are: 1) new investment review mechanisms and updates to existing laws have increased markedly in recent years; 2) the scope of sectors subject to screening has expanded, either through blanket cross-sectoral review or through the addition of new sectors covered; 3) investment review mechanisms cover increasingly smaller transactions, both in terms of absolute valuation and as a percentage of deal size; and 4) disparate national screening mechanisms have shown increasing convergence over time.

Both the dataset and the research agenda we laid out above will allow scholars to question and test some of the theoretical and policy puzzles related to the causes of ISMs such as: the conditions under which countries are more likely to develop and alter such instruments, what those mechanisms look like, and how different domestic features influence key elements of the mechanisms. Other interesting questions relate to the original differential designs of ISMs and their increased convergence over time. Is this convergence happening through diffusion or competition, with screening as an example of regulatory proliferation?

Finally, our data will enable scholars to study the implications of these disparate screening rules on a host of economic and political outcomes. One important question is whether investment screening is a defensive or offensive mechanism. Are ISMs used primarily to protect against actual or perceived threats, or are screening measures explicitly used as bargaining tool to obtain concessions from other countries, especially China? By further exploring the politics of ISMs, scholars can meet the growing need to make sense of how societal interests shape and are being shaped by a growing geoeconomic turn in IPE.

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Appendix

Country	Current Law Enacted	Scope	Threshold	Net Benefit	Pre-auth
Australia	1975	cross-sectoral	40% -> 0%	yes	2020
Austria	2011	7 -> 18 sectors	25% -> 10%	no	yes
Belgium	NONE				
Canada	1985	cross-sectoral	changes yrly	yes	when net benefit test applies
Chile	NONE				
Colombia	NONE				
Costa Rica	NONE				
Czech Republic	2021	cross-sectoral	10%	no	strategic sectors
Denmark	2009	mixed	40% -> 10%	no	strategic sectors
Estonia	2012	real estate	0	yes	yes
Finland	2012	4 sectors	50% -> 10%	no	defense
France	1999	6 -> 17 sectors	40% -> 25%	no	yes
Germany	2013	mixed	25% -> 10%	no	strategic sectors
Greece	NONE				
Hungary	2019	4 -> 19 sectors	25/10 -> 10%	no	yes
Iceland	NONE				
Ireland	NONE				
Israel	2019	5	unclear	no	no

Italy	2012	4 -> 20 sectors	10%	no	yes
Japan	1980	7 -> 12 sectors	10% -> 1%	yes	strategic sectors
Latvia	2017	3 sectors	10%%	no	yes
Lithuania	2009	4 -> 8 sectors	25%	no	strategic sectors
Luxembourg	NONE				
Mexico	1993	2 sectors	10%	yes	yes
Netherlands	2012	2 sectors	51% or contractual relationship	no	yes
New Zealand	2005	cross-sectora l	25 -> 10%	no	strategic sectors
Norway	2018	6 sectors	33%	no	yes
Poland	2015	3 sectors	20%	no	yes
Portgual	2014	cross-sectora l	"control"	no	no
South Korea	1998	asset-based	10%	yes	defense
Slovak Rep	2021	4 sectors	10%	no	yes
Slovenia	2020	8 sectors	10%	no	no
Spain	2020	mixed	10%	no	strategic sectors
Sweden	NONE				
Switzerland	NONE				
Turkey	1982	real estate	unclear	no	yes
UK	2021	cross-sectora l	25%	no	strategic sectors
US	2007	cross-sectora l	"control", non-control	no	"control" for most

			non-passive for some		