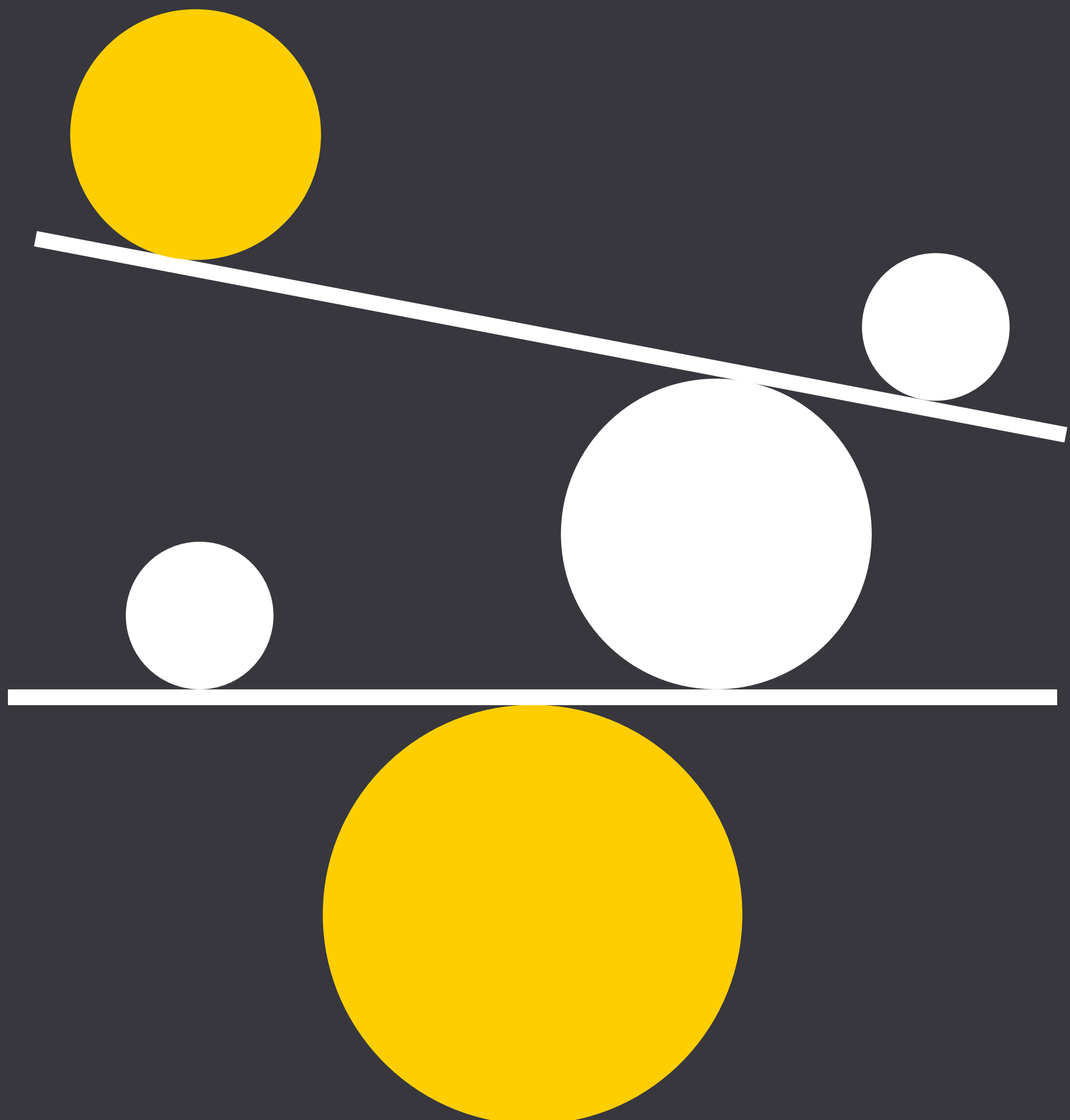
BALANCING ANTITRUST AND NATIONAL SECURITY IMPACTS OF FOREIGN INVESTMENT IN THE U.S.



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We are in a world where U.S. 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, Washington has been moving in a direction where such tradeoffs are seen as illusory: some U.S. policy makers judge the loss of competition, itself, as constituting a threat to national security. This was largely the case in the 1980s when Japan was in the sights of U.S. international economic policy. Today, however, Washington is dealing with a far more combustible mixture: unlike Japan, a liberal democracy, China is neither liberal nor a democracy. The challenge now before U.S. policy makers is thus how to deal with foreign direct investment from a country that is viewed as presenting a combination of threats to competition and national security. Effectively confronting that challenge requires a new analytical framework that provides a decision-making calculus to maximize the chances of achieving a balance by distinguishing between new domestic entrants versus new foreign entrants.

I. CHANGES IN THE ANTITRUST-FOREIGN INVESTMENT NEXUS

For decades, U.S. policy toward foreign direct investment was one of the most liberal in the world. Indeed, most Presidents, often soon after they took occupancy of the Oval Office, issued formal statements proclaiming America welcomes foreign direct investment. The raison d'être articulated in such proclamations was to not only assure investors abroad their capital was welcome in the U.S. but to also declare that investment of foreign capital boosts the growth of the U.S. economy, creates jobs for Americans and stimulates innovation on our shores.

The tenet underlying how such outcomes are engendered by U.S. receptivity to capital from abroad is that, in the aggregate, entry of foreign firms and inflows of other forms of cross-border investment enhance competition among businesses operating in the U.S., which in turn bolsters the global competitiveness of the U.S. economy. Conversely, a national policy that shields U.S. markets by erecting barriers to entry of foreign capital jeopardizes the ability of competitive forces to work, placing at risk economic growth, business ingenuity, and the dynamism of, and mobility within, U.S. labor markets.

We antitrust economists fully understand these arguments. We view inbound foreign direct investment flows as a twofer: providing a source of capital and stimulating competitive forces and thus a check on the exercise of market power by incumbent firms. In this latter sense, foreign direct investment can be seen as a powerful instrument of antitrust policy.

Of course, as in the case of domestic investors, the impact on market competition from foreign direct investment depends on the *mode of entry*. Foreign direct investment that establishes wholly new business operations (whether on the supply- or buy-side of a market) is, 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 (generally if it results solely in change of ownership) or serve to reduce competition (if the transaction reduces the number of independent suppliers or buyers).

In the past two decades, however, U.S. public policy towards foreign direct investment has fundamentally changed. This 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 U.S., and has rapidly become the "world's factory" — a well-deserved moniker in light of the global supply chain disruptions emanating from China over the course of the COVID pandemic.[2] At the same time, Beijing's global miliary and investment alliances — especially in East and South Asia, as well as in Africa, Latin America and the Middle East — have also grown substantially in recent years.

The result is that while foreign investment writ large is still welcome in the U.S., it now increasingly depends on *what is the source country* of such capital. In essence, not all foreign direct investment is the same. The principle of foreign investment's competition-inducing effects is still acknowledged. But of equal, if not greater, significance are the risks to national security that the US may be exposed to from foreign investment from certain geographies.

Symbolic of this shift is the fact that Barrack Obama was the last President to issue a formal statement on U.S. policy welcoming foreign investment — in 2011.[3,4] At the same time, as a result of Congress's bipartisan passage of the Foreign Investment Risk Review Modernization Act ("FIRRMA") in 2018, the authority of the executive branch's interagency Committee on Foreign Investment in the United States ("CFIUS") — the entity which reviews national security impacts of foreign investment — has been significantly enlarged.[5] (For full disclosure, I was a member of CFIUS during my tenure in the White House a number of years ago.)

We are now in a world where U.S. 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, Washington has been moving in a direction where such tradeoffs are seen as illusory: that is, some U.S. policy makers judge the loss of competition, itself, as constituting a threat to national security. This was largely the case in the 1980s when Japan was in the sights of U.S. international economic policy.

2 https://www.forbes.com/sites/harrybroadman/2021/10/31/wto-peer-review-of-chinas-trade-regime-should-rouse-biden-from-trumps-perverse-approach/?sh=7948ae4f7758.

3 https://obamawhitehouse.archives.gov/the-press-office/2011/06/20/statement-president-united-states-commitment-open-investment-policy.

4 https://www.forbes.com/sites/harrybroadman/2021/01/31/bidens-economic-policies-should-eclipse-trumps-in-style-and-substance/?sh=621319ed674b.

5 https://www.iflr.com/article/b1tw30h39pml78/cfius-annual-report-reveals-a-maturing-agency-with-increased-agility.

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

Effectively confronting that challenge requires a new analytical framework that provides a decision-making calculus to maximize the chances of achieving a balance by distinguishing between new domestic entrants versus new foreign entrants.

II. TOWARD A DECISION-MAKING FRAMEWORK TO BALANCE FOREIGN INVESTMENT'S EFFECTS ON COMPETITION AND NATIONAL SECURITY

Domestic Entrants. 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 in the U.S. is to be applauded.[6] All other things equal, the presence of such additional suppliers or purchasers should enhance the degree of inter-firm competition, which, in turn, is expected to result in lower prices and broaden consumer choice.

The competitive effects of greenfield entry by domestic firms are also assumed to include the stimulation of product or process innovation in the marketplace. Indeed, one of the factors that often enables new domestic enterprises to enter markets successfully — even if there are small in scale relative to incumbents — is the competitive advantage they possess arising from innovation they've undertaken. Such dynamic effects on competition by small upstarts are, of course, pronounced in advanced technology industries.

Of course, it is a wholly different matter when entry is not *de novo*, but rather takes the form of a domestic party (or parties) acquiring or merging with an established U.S. firm or a set of incumbent U.S. 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.

The principles and parameters that guide making such judgments by the U.S. antitrust authorities and courts stem from the nation's antitrust statutes, especially Section 7 of the Clayton Act, which prohibits mergers and acquisitions when the effect "may be substantially to lessen competition, or to tend to create a monopoly," as well as the Department of Justice's and Federal Trade Commission's "Merger Guidelines," issued periodically under the authority of the Hart-Scott-Rodino Act. The Biden Administration is currently reviewing the current version of these merger guidelines with an eye towards adopting a more aggressive approach to restraining anticompetitive horizontal and vertical mergers and acquisitions.[7]

Foreign Entrants. This stripped down stylized neoclassical model for assessing competitive impacts of market entry does not distinguish between whether greenfield firms or acquirers/merger partners are domestic or domiciled in foreign countries. In such a world, entry through foreign investment — whether in the form of non-controlling foreign portfolio investment or controlling foreign direct investment — is generally seen as salutary.

In practice, of course, assessing the extent to which the degree of "foreignness" of new entrants has a beneficial or deleterious impact on competition or economic welfare in a market, including whether such firms face higher or lower (implicit or explicit) barriers to entry — has long been a staple of empirical research by industrial organization economists.

With the risk of making sweeping generalizations, 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.

For example, the findings in the literature suggest that, historically, entry decisions through merger or acquisition by foreign firms tend to be more sensitive to the risk or uncertainty of host nations' various policies toward such forms of entry than are domestic firms, even when controlling for sectoral differences (inasmuch as sectors characterized by higher fixed costs entail greater risk exposure to new entrants since exit will be more costly).

6 The exception, of course, are markets that are generically characterized by large economies of scale and/or scope. In such sectors entry (and exit) are subject to some form of government regulation.

7 https://www.reuters.com/legal/transactional/back-drawing-board-ftc-doj-rethink-merger-guidelines-2022-03-07/.

In the case of foreign firms' greenfield entry, historically the results are less mixed. This is due to the fact that host country policymakers, all other things equal, place greater value on foreign investments that entail generating new productive capacity and jobs in local markets. Indeed, like other countries, in the U.S., individual states compete with one another to offer tax credits and other benefits to attract greenfield foreign investment.

Reconciling Antitrust and National Security Policies. While the policy tools at play assessing the economic welfare impacts of market entry matters were once the sole province of U.S. 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 U.S. national security into the mix. Today, where foreign investments in the U.S. are concerned, the public policy assessments of such transactions are a product of the interaction between antitrust and national security policies.

Once a little-known agency, the authority of CFIUS, which dates back to 1975, underwent important embellishments with the enactment of the Exon-Florio Amendment in the Omnibus Trade Act of 1988, and even more so with the passage of FIRRMA in 2018.

CFIUS is chaired by the Treasury Department and its standing members include the other principal agencies involved in trade (Office of the U.S. Trade Representative), commerce (Department of Commerce), defense (Department of Defense), foreign policy (State Department) and science and technology matters (Office of Science and Technology Policy), as well as some sectoral agencies, such as the Department of Energy, are also standing members of CFIUS.[8]

Importantly, the Justice Department is a CFIUS standing member. This means the top U.S. federal authority that oversees antitrust policy, as well as many other criminal matters, including foreign corruption, is present for all CFIUS deliberations.

To this end, *some* of the balancing between national security and antitrust will take place within the confines of CFIUS deliberations. However, the current legal authority — FIRRMA — under which CFIUS operates and makes judgments about national security, including bringing to the President proposals to suspend or block a transaction if there is "credible evidence" that the transaction threatens to impair U.S. national security, 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) are authorized to make decisions on antitrust policy do not specify that consideration of national security impacts are to be taken into account in coming to those judgments.

Yet at the heart of both policy regimes lies the criterion of "control."

In the case of antitrust, essentially the fundamental operative question turns on the extent to which an entity (or entities) by dint of its (their) 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 can be voiced for smaller firms.

With respect to CFIUS's 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)) has the ability to function in such a way that elevates national security risks. In fact, under FIRRMA, even minority shareholders could be seen as having sufficient authority cause such threats (or conversely have enough rights to block actions that would otherwise forestall diminution of such threats.

III. SKELETAL TAXONOMY FOR DECISION-MAKING.

Against this backdrop, it is useful to sketch out a rudimentary taxonomy that can help guide decision-making in assessing foreign investment's effects on competition and national security. We distinguish between foreign investment transactions involving (i) private enterprises vs state-owned enterprises and between entry on a (ii) *de novo* basis vs. by acquisition.

8 Beyond the departments that are standing CFIUS members, depending on the specific transaction under review by the Committee, other agencies participate in its decisions on an as needed basis.

Type of Transaction	Criteria for Antitrust and CFIUS Assessments
Private Foreign Firm Entry Via Acquisition	Could raise *both* **antitrust** and **CFIUS** concerns. · **Antitrust** issues likely to arise since transaction may reduce number of otherwise independent sellers and/or buyers in the market. · Routine **CFIUS** assessment of inbound transactions, where outcome depends on (i) sector in question and (ii) resulting shareholding control.
Private Foreign Firm Entry on a De Novo Basis	**Antitrust** concerns likely *de minimis*; **CFIUS** concerns are toughening on greenfield investments · Rationale for **antitrust** intervention likely to bear burden of proof, insofar as transaction could well *enhance* competition due to increase in number of suppliers or buyers. · In the past, **CFIUS** risk was seen as relatively low. However, recent Congressional interest in potentially amending FIRRMA so as to cover even greenfield investments — depending on (i) sector (e.g., real estate) and (ii) nationality of investor (e.g., risk profile of private (non-state) Chinese firms are viewed differently than private Canadian firms
State-Owned Foreign Firm Entry Via Acquisition	Could raise *both* **antitrust** and **CFIUS** concerns. · **Antitrust** concerns will focus on reduction in number of buyers or sellers · **CFIUS** concern will likely be significant — perhaps both regardless of sector and regardless of share of ownership
State-owned Foreign Firm Entry on a De Novo Basis	**Antitrust** concerns could be limited, but may increase over time. **CFIUS** concerns regarding greenfield investments, particularly by foreign state-owned firms, are intensifying. · **Antitrust** authorities may have few concerns, since there would be new sellers or buyers. But if risk of state-fostered subsidization, especially if it leads to the exercise of market power, and at the extreme, predatory pricing, antitrust scrutiny likely. Such actions assumed to occur *ex post* of transaction consummation. However, will *ex ante* stipulations be made (or even set as a condition of the transaction)? · New Congressional initiatives are emerging to scrutinize national security risk of greenfield investments — especially those involving foreign state-owned enterprises. *Ex ante* **CFIUS** review likely to be triggered.

IV. CONCLUSION

The policy taxonomy sketched out above represents a static view — that is, it portends a set of parameters for a given point in time. Of course, changes in these parameters will come about either because of amendments to the antitrust statutes and/or to the law underlying CFIUS's authority (that is, FIRRMA). In fact, on both counts, such changes are afoot in Washington at the present time.

In addition, case precedents set in both areas could propel changes. Alteration of the globe's political economy environment (think Russia's war in Ukraine or China's conduct toward Taiwan), will also generate changes. Any of these factors could alter the decision-making calculus.