

Foreign investment regimes: three things the West needs to better protect national security



As concern over strategic investments increases, many countries now seek to adapt their rules around foreign direct investment (FDI) and national security. [Ashley Thomas Lenihan](#) writes that consistent rules, open lines of communication, and institutional capacity are all needed to have an effective transatlantic coordination regime on FDI and national security that fully addresses the risks posed by strategic foreign investments from China, Russia, and beyond. This is the fourth in a series of blog posts summarising the new report [‘Protect, Constrain, Contest’](#), by [LSE IDEAS](#), the foreign policy think tank at LSE.

Many countries throughout [modern history](#) have used state-backed or -influenced investments abroad to achieve their strategic goals. While the conversation currently focuses on China, investments from *other* countries have been [blocked or unwound](#) on national security grounds by Western governments – and our competitors will continue to use foreign investment as a tool of statecraft in future. Even investments [from our closest allies](#) can potentially threaten national security, especially if those allies have previously failed, for example, to adhere to export control laws designed to keep critical technologies out of competitors’ reach.

As concern over strategic investments increases, many countries now seek to adapt their rules around foreign direct investment (FDI) and national security. At least [11 jurisdictions](#) made changes in 2020, amid fears over the security of depressed assets and supply chains raised by the pandemic. So, how do we ensure foreign investment regulations in the West are effectively screening out sophisticated and strategically motivated government-influenced or controlled FDI? [I argue](#) that there are three things we need to do to better secure the West against harmful foreign investment while remaining open to legitimate FDI.

1. Adopt consistent rules in line with best practice

Western allies should adopt clear and consistent rules on foreign investment and national security in line with international best practice as outlined by the [OECD Guidelines for Recipient Country Investment Policies](#). This would allow for a decentralised FDI security architecture to protect the interests of the Five Eyes and NATO countries in a coherent, rule-based way.

While the ability to block FDI on national security grounds is a sovereign right under international law, adopting domestic laws providing clear jurisdiction, enabling mechanisms, and review processes makes it more likely threatening strategic investments will be detected, and benign foreign investors will not be deterred. Allies lacking scrutiny mechanisms should be encouraged to adopt them, and those with such mechanisms should be encouraged to update them to respond to the wide range of existing and emerging threats.

The US provides a good model, as one of the oldest, most institutionalised, review regimes with clear guidelines for intervention, frameworks for risk assessment, and a history of successful mitigation. The proposed [National Security and Investment Bill](#) should bring the UK in line with best practice, providing a comprehensive regime intended to be non-discriminatory, transparent, proportional, and accountable. To be fully effective, however, the government must provide the infrastructure and resources [required for success](#).

The EU faces a different challenge. Its 2020 [Framework](#) for screening FDI allows it to raise concern over investments threatening *EU-wide* security, while protecting member states’ right to make the final decision about FDI in their country. Yet, just over [half of EU states](#) have regimes in place, and these differ dramatically in terms of process, coverage, and institutional capacity. For the Framework to be effective, many member states will need new regulations, or to bring existing ones up to par.

Finally, best practice among Western allies should ensure FDI regulations focus only on *national security*, rather than *national interest* or other protectionist considerations. Conflating these concepts sows confusion among investors and undermines the argument that legitimate national security assessments of FDI are possible.

2. Open lines of communication and intelligence cooperation

It is vital that Western allies have open lines of communication on FDI-related security issues. Particularly when an investment poses a national security risk but takes place extraterritorially. Some states, including the [US](#) and [China](#), have made domestic legal provisions for jurisdiction over certain foreign investments abroad that impact national security at home, as will the [UK bill](#). But such rulings are difficult to enforce without cooperation from the target state. Convincing another government to enforce a third-party block on an investment in their country (or to block it themselves) requires the highest levels of intelligence sharing, trust, and coordination. It also helps to have established contacts and lines of communication in allied states on this issue.

Strategically motivated investments are also getting more sophisticated in order to evade ‘capture’ by existing review regimes, often using acquisition vehicles that make it difficult to trace ultimate ownership or effective influence. In such cases, information and intelligence sharing among allies can be crucial in determining foreign influence and control over potential acquirors. Recent [UK](#), [EU](#), and [US](#) legislation make positive moves in this direction, enabling intelligence coordination and data sharing while establishing lines of communication. Designated experienced points of contact among allied states will be needed, requiring investment in time and resources. Exchange programs between personnel of allied review regimes may also be useful for training, establishing trust, and building relationships.

3. Institutionalise a culture of best practice and transparency

Finally, a strong institutional culture and deep institutional capacity is needed to support the review regimes in Western states, to ensure they have the capacity to do their jobs, while maintaining Western liberal economic values in the face of competition from more closed economies. Strong institutions with multi-agency involvement – like the Committee on Foreign Investment in the United States ([CFIUS](#)) – are better able to withstand outside political pressures and focus on national security remits.

As national security related FDI reviews grow in volume and complexity, key questions for Western allies include: Do they have the information, databases, and tools needed to adequately assess risk? Are they well-staffed? Do those staff have the security clearances and training needed to do their jobs effectively? Even with CFIUS’ deep capacity drawing from [multiple agencies](#), recent [US legislation](#) included greater funding and staffing to meet a more demanding caseload. The new UK regime may face challenges in this area, with a large expected caseload across a variety of sectors. Many European regimes will similarly require improved capacity and resourcing, emphasising the value of cooperation between allies on this issue in future.

In sum: Consistent rules, open lines of communication, and institutional capacity are all needed to have an effective transatlantic coordination regime on FDI and national security that fully addresses the risks posed by strategic foreign investments from China, Russia, and beyond.

- *This article first appeared at [LSE Business Review](#) and is based on the new LSE IDEAS report ‘[Protect, Constrain, Contest](#)’.*
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