PROPORTIONALITY OF SECURITY-RELATED INVESTMENT INSTRUMENTS: A SURVEY OF PRACTICES

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Executive summary

Proportionality means that restrictions on investment, or conditions on transactions, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address national security concerns. Most countries assign little or no role for investment policy in managing the national security risks. Among those countries that do use investment policy for protecting national security, risks to be addressed through investment reviews included: infiltration of the national economy by organised crime or terrorists; loss of control of key resources needed for national defence, impeding law enforcement, and loss of control of border or security-sensitive geographic locations. Among the 11 countries participating in the FOI project that have investment review panels charged with addressing national security concerns, 6 reported that their panels have a repertoire of possible responses in addressing these concerns. These include reaching agreements between the recipient government and a foreign investor on how specific security concerns raised by a particular investment are to be addressed. This allows the investment panel to take steps that fall short of completely blocking the proposed investment. One country has also provisions which require the authorities to be satisfied that no other existing regulations deal adequately with the problem before deciding to restrict a transaction.

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Proportionality – restrictions on investment should not be more costly or more discriminatory than needed to achieve the security objectives and they should not duplicate what is, or could be, better dealt with by other regulations.[1]

Introduction

Proportionality (see definition above) is one of the three principles that participants in the "Freedom of Investment, National Security and 'Strategic' Industries" project agreed should guide investment policy measures addressing national security concerns. Phase II of the project involves identification of lessons learnt and of good practices that contribute to regulatory proportionality, transparency and predictability and accountability, based on country submissions and exchanges of experience. During Roundtable VI, participants exchanged information and described experiences with measures that affect transparency. This note aims to support dialogue about proportionality at Roundtable VII. It summarises seventeen responses to a questionnaire on proportionality.[2]

The summary contains four sections. It begins with a summary of participating countries' descriptions of their general approaches to national security. Then it follows the section headings of the questionnaire: evaluating investment-related concerns about essential security interests; assigning regulatory authority to the most appropriate government body; tailoring investment policy responses to specific investment proposals. The final section proposes issues for discussion.

General approaches to national security

National security concerns are "self-judging", but some of the questionnaire responses shed light on how governments make these judgements. Three countries (Austria, Czech Republic and Poland) describe their general strategies for identifying and managing risks related to national security and other essential interests. Austria and the Czech Republic describe their general national security arrangements, while Poland describes its critical infrastructure policy. Overall, these plans seem to have been formulated using formal risk assessment and management techniques[3] (see *Emerging Risks in the 21st Century: An Agenda for Action* OECD 2003 for a description of these techniques).

These policies can be summarised as follows:

- *Austria* describes its general security arrangements and notes that it "does not maintain any discriminatory practices for foreign investors or screening mechanisms based on national security considerations or related concerns." Austrian national security policy involves a comprehensive approach to security. Risks and "dangers" identified in the policy include: terrorism, military threats, economic and technological espionage, natural and environmental disasters, epidemics and economic and financial crises. Implementation of the strategy relies on cooperation among various policy areas on the basis of "sub-strategies" identified for those areas (e.g. national defence, but also economics, agriculture, transport, infrastructure, and financial policy).

1 2007 Interim Report by the OECD Investment Committee www.oecd.org/dataoecd/1/24/40476055.pdf.

2 The respondents to the questionnaire include: Argentina, Austria, Belgium, Canada, Czech Republic, Finland, France, Germany, Italy, Japan, Korea, Mexico, Netherlands, Poland, Spain, Turkey, United States.

3 *Emerging Risks in the 21st Century: An Agenda for Action* OECD (2003) Emerging *Risks in the 21st Century* discusses these techniques

Austria's policy also stresses the importance of international cooperation in addressing security concerns.

- The *Czech Republic* also has a formal national security plan. This includes 23 special sub-plans for handling major threats including large scale floods, epidemics, radiation accidents, disruption of waterworks and water supply, of energy supplies or of computer networks. For each plan the responsible body does all evaluations needed and coordinates with necessary authorities and entities. The responsible public bodies include intelligence services; military intelligence; the National Security Council and ministries with sector-specific responsibilities.
- *Poland* provides information on its strategy for the protection of critical infrastructure. The strategy includes measures to facilitate "cooperation among parts of government, with critical infrastructure operators and other interested entities, which are aimed at effective functioning or behaviour or regeneration in case of threats, failure, attacks and other events which may disrupt correct operations." Poland participates in EU projects on critical infrastructure protection.

Evaluating investment-related concerns about essential security interests

General security concepts used in investment policy. Several countries provided descriptions of the concepts of essential security interests used in their investment policies. These are summarised in Table 1. Typically, the concepts involve basic notions such as national defence, public health and safety, and public order. Italy's description in which the special powers foreseen under its "golden shares" policy resembles the set of comprehensive risks identified in many national strategies for critical infrastructure protection (e.g. disruption of energy supply, of government services, pandemics, destruction or disruption of infrastructure; see DAF/INV(2007)21/REV1). Some of the national concepts refer to the sporadic nature of security risks. For example, France and Spain's questionnaire responses note that risks will be considered, even if they are only posed "occasionally" (these appear to be indirect references to the problem of "rare events" in risk management[4]). In a few cases, national concepts for essential security interests appear to go beyond what might be considered "traditional" security concerns.

More specific risks addressed by investment policy. Some of the questionnaire responses provide insights into the more specific risks that some countries feel might, in certain cases, be mitigated by investment policy measures. These include threats related to: acquisition of real estate in border areas or in areas near to strategically important facilities (Argentina); foreign investments in defence/armaments/munitions (Argentina, France, Germany, Korea); organised crime (Argentina, France); money laundering (Argentina); protection of state secrets (Korea); diversion of strategic capabilities for military purposes (Korea); investments which might hinder efforts of international organisations to maintain international peace and security (Korea).

Relations between sectoral lists and concepts of essential security. Several countries, including France, Germany and Japan, base their investment review procedures on sectoral lists. That is, proposed investments in sectors on these lists are, in principle, subject to review. The link between these lists and national assessments of essential security concerns is a matter of some interest. Germany's questionnaire response notes that its list covers a narrow range of activities – weapons of war and cryptographic equipment -- which it views "*a priori*, as relevant for national security purposes." France states that its list

[4] The problem of 'rare events" refers to events that occur infrequently, but, have high costs when they do occur (loss of human life, property or environmental damage). Although their rarity makes it is difficult to evaluate such risks, they still may need to be factored into the risk management strategy.

of 11 sectors[5] is closely linked to the concept of essential security concerns set forth in its primary legislation (see entry for France in Table 1).

Assigning regulatory authority to the most appropriate body

The questionnaire responses show, first of all, that countries are generally confident that, when it comes to dealing with essential security concerns raised by foreign investment proposals, they have coordinated and reasonable approaches to assigning responsibilities to different government bodies. Many note that the allocation of responsibilities is explicitly dealt with in national legislation and regulatory practice. The United States notes that its security-related investment policies are policies of last resort – that is, investment policy enters into play only if other policies are unable to address security concerns.

Two main types of policies appear to be involved:

- *Licensing and permits*. These are generally managed by government bodies that are responsible for particular sectors (e.g. telecommunications for broadcasting licenses) or functions (e.g. interior ministry or homeland security for real estate acquisitions in sensitive areas). The US response suggests that any measures taken under its investment review procedure (CFIUS) may be applied only when these more specialised procedures, i.e. other existing laws or regulations, do not adequately address a given national security concern.
- Several *investment review procedures* are described (France, Germany, Japan, Spain, the United States). Table 2 summarises the government bodies that are reported to be involved in these procedures. Often there is a lead body (often a finance ministry or treasury) and other bodies are called upon to contribute, according to the requirements of particular transactions. In some cases, Ministries bringing important national security and intelligence expertise participate in the review process (e.g. National Security Agencies, Ministries of Defence, intelligence agencies), whereas in other cases this national security expertise appears to be absent.

Tailoring investment policy responses to specific investment proposals

The questionnaire poses a series of questions on the degree to which investment policies provide for a "repertoire of responses" to proposed investments that may pose national security threats. Generally, flexibility is provided by the possibility of reaching special agreements between the investor and government authorities (referred to as mitigation agreements, compacts, public contracts, etc). These commit the investor to addressing specific security concerns – a measure that falls short of completely blocking the investment. The availability of policy responses that are calibrated to the nature of the risk allows host countries to find a better balance between open investment markets and safeguarding national security concerns.

The questionnaire responses show that many countries with investment review procedures or other measures (e.g. golden shares) provide for flexible responses by government authorities. Examples include:

5 The 11 sectors are: aerospace construction; nuclear energy; activities related to interception and detection of communications; evaluation and certification of security systems; activities related to dual-use technologies; cryptology; activities by enterprises privy to classified defence information; production and trade in arms, munitions, gunpowder and explosives for military purposes as well as war materiel; activities by enterprises having concluded research or supply contracts with the Ministry of Defence; research, development and production of means of protection against the illicit use, through terrorist activities, of pathogenous or toxic agents as well as their health impacts; and casinos.

- France. Legislation presents a list of conditions that might be imposed on the foreign investor (e.g. the investor must commit to assuring the continuity of the activity, the industrial capacity, research and development capacity and other associated know-how, surety of supply, execution of contractual obligations of acquired entity as a contracting party or subcontractor in transactions relating to public safety, national defence and various activities in the arms industry).
- Germany. The investor may enter into a public contract with the Federal Government to resolve concerns relating to national security.
- Japan. "If the government of Japan finds it appropriate, after examination of an investment, it could recommend or order the investor not only to cancel the investment, but also to change the investment content."
- Korea. Particular investment proposals that may pose threats to essential security interests may "be allowed under the condition the investors sign a compact not to expose any state secrets or to sell facilities producing the defence industry-related materials in question."
- Italy. The special powers foreseen in Italy's "golden shares" legislation "may be exercised in a conditioned fashion".
- United States. US law "provides that any mitigation agreement must be based on a risk-based analysis of the threat to national security posed by the covered transaction. … any steps taken by CFIUS or the President … are narrowly tailored to address the specific national security risks posed by the transaction."

Table 1. Concepts of Essential Security Interests

Country	**Concepts of Security, Vulnerability or Threats used in Investment Policies** **(e.g. investment review procedures, golden share arrangements)**
Finland	National interest is to a) safeguard the national defence b) prevent serious and probably permanent economical, social or environmental difficulties on sectoral or regional level and c) secure public order, citizens' security and health.
France	The risk evaluation takes account of sectors of activity. Activities considered to be risky are those that, even if only occasionally, participate in the exercise of public authority or that have the following characteristics: • activities that might undermine public order, public security or national defence; • activities involving research, production or commercialisation of arms, munitions, powders and explosive substances.
Italy	The "special powers" foreseen by Italy's "golden share" legislation can be exercised in the following circumstances: • grave and real danger of scarcity in the national supply of oil and energy products; in the supply of related services and, in general, of raw materials and essential goods for the community; in a minimum supply of telecommunications and transport supply • grave and real danger as far as the continuance of exercise of public services is concerned and as far as the pursuit of public interest goals are concerned • grave and real danger to public services' infrastructures and networks • grave and real danger to national defence, military security, public order and public security • sanitary emergencies.
Poland	The investment [in real estate] does not "result in a threat to the defence, state security or public order and if it is not against the social and health policy and if the foreigner demonstrates circumstances proving his/her relations with Poland."
Spain	"public security or order or public health … The Spanish Council of Ministers can suspend, by justified reasons, the application of deregulation rules of RD 664/19999 to investments that, because of their nature, form or conditions to which they are subject, affect or may, even if only occasionally, affect activities relating to the exercise of governmental power or activities that affect or could affect public order, security or health."

Table 2. Government bodies participating in Investment Review Panels

Country	**Defence Ministry**	**National Security Council**	**Economics/ Finance/ Trade Ministry**	**Other government bodies that may participate in investment review procedures**
Finland	x	x	x	Environment and sustainable development
France	x	x	x	The competition authority may also participate
Germany			Federal Ministry of Economics and Technology	
Japan	x	Japan does not have a National Security Council	x	Other ministry responsible for the policy area for which the investment raises concerns
Korea	x		x	Also participating are the Ministries of Strategy and Finance; of Foreign Affairs and Trade; of Food, Agriculture, Forestry and Fisheries; of Education, Science and Technology; of Culture, Sports and Tourism; of Environment, Ministry of Labour; of Land, Transport and Maritime Affairs and concerned Ministries
Spain	x		General Directorate for Trade and Investment	All ministries are represented on Spain's Foreign Investment Board.
United States	x	x	Department of Treasury	Also Secretaries of State, Commerce, Energy, Homeland Security, Labour as well as the Attorney General and the Director of National Intelligence. United States Trade Representative; Office of Science and Technology Policy; the heads of any other executive department, agency, or office, as the President or the Secretary of the Treasury determines appropriate, on a case-by-case basis. The following bodies may serve as observers: the Office of Management and Budget; the Council of Economic Advisers; the Assistant to the President for National Security Affairs; the Assistant to the President for Economic Policy; the Assistant to the President for Homeland Security and Counterterrorism.