Foreign Acquisitions and National Security: What are Genuine Threats?
What are Implausible Worries?

A Framework for OECD Countries, and Beyond

Theodore H. Moran

Non-Resident Senior Fellow,
Peterson Institute for International Economics
Threat I:
the proposed acquisition would make the country where the acquired firm is located dependent upon a foreign-controlled supplier of goods or services crucial to the functioning of that economy who might delay, deny, or place conditions upon provision of those goods or services.
For there to be a credible likelihood of Threat I, the industry must be tightly concentrated, the number of close substitutes limited, the switching costs high.
When the Russian firm Evraz proposed to acquire Oregon steel, it was clear that steel was a “crucial” input for the United States.
The multiplication of sources of supply around the world means that there is no realistic likelihood that an external supplier (such as Russia) could withhold steel from US purchasers, or place conditions upon US purchasers or upon the US government in order to take delivery.
THREAT II:
the proposed acquisition would allow transfer of technology or other expertise to a foreign-controlled entity that might be deployed by the entity or its government in a manner harmful to that country’s national interests.
Lenovo’s acquisition of IBM’s PC business in 2005:

More than a dozen producers compete for fifty percent of the PC market, with no one showing a predominant edge for long.
Threat III: the proposed acquisition might allow insertion of some potential capability for infiltration, surveillance, or sabotage into the provision of goods or services crucial to the functioning of that economy.
Dubai Ports World: US fears that the new owner might be less than vigilant in preventing hostile forces from infiltrating the operations of the acquired company, or might even be complicit in facilitating surveillance or sabotage.
The argument that the goods or services provided by the target of a foreign acquisition are critical to the national interest is a necessary but NOT a sufficient condition to block the acquisition.
When competition among rival suppliers is high and switching costs are low, there is no genuine national security rationale for blocking a proposed acquisition no matter how crucial the goods and services the target company provides.
A foreign company may acquire the “last remaining” national producer of a given good or service, but the international market is sufficient competitive that this makes no difference for the national security of the home country.
This decision-tree is basis OECD-wide standards, and for mirror-image legislation among countries around the world.
OECD-Wide (or World-Wide) Decision-Tree
When is there a Plausible National Security Rationale to Block a Proposed Foreign Acquisition?

**CRITICALITY TEST**

**THREAT I** How much would the costs be if provision of the acquired firm’s goods or services were denied or conditions placed upon their supply?

**THREAT II** How much national security-related advantage would be gained by the foreign purchaser and its government if the foreigner gained control of the target firm?

**THREAT III** How extensive would the damage be from surveillance or disruption via foreign ownership of a given network?

**Plausible Threat Test**

Are there widely available substitutes for goods and services of target acquired firm in global markets, competitive suppliers in global markets, low switching costs?

**HIGH CRITICALITY**

**HIGH PLAUSIBILITY**

**NO**

**ALLOW FOREIGN ACQUISITION**

**ALLOW FOREIGN ACQUISITION**

**LOW CRITICALITY**

**LOW PLAUSIBILITY**

**YES**

**Block Foreign Acquisition**

Only if this leaves the Nationally-Owned Target of Acquisition Internationally Competitive or Capable of being Internationally Competitive

**Allow Foreign Acquisition**

If this is the Only Way for the Nationally-Owned Target of Acquisition to Become or Remain Internationally Competitive
To operationalize concern about market control and collusion use the long-standing US Department of Justice/Federal Trade Commission -- or the similar EU DG for Competition -- guidelines on mergers and acquisitions.
It is in the interest of both home and host countries around the world to maintain a global regime that allows international investment flows steadily to expand.