Each morning before sunrise an army of traders arrive at their desks, switch on their screens, and start fielding calls. On most days, the flow of trades that pass through their hands represents the normal activity of an ever-deepening, globally interdependent financial market. These traders coordinate a complicated international marketplace, where orders usually come from institutional investors motivated solely by the maximization of profit.

Yet, some days are different, and on those occasions this army of civilians may receive calls motivated not by profit, but by a different calculus entirely: a calculus based on a long-term understanding of the power of states, and of how that power is achieved, managed, and balanced over time. When that happens, these traders in front of their Bloomberg terminals seem more like frontline soldiers manning the radars, as a battle for national power – where the economy of the nation is understood to be paramount to its future fortunes – is played out through them.

Such battles on the open market do happen. One only need talk to the traders who witnessed the dawn raid on Rio Tinto’s stock in 2008 to understand this. At that time, the Australian mining company BHP Billiton was planning to acquire Rio Tinto, a miner and producer of iron ore, aluminum, copper, and other metals that was listed on both the Sydney and the London stock exchanges. China, already the largest importer of iron ore, showed concern that the combination of Rio and BHP would lead to a near monopoly over the seaborne iron ore imports vital to its growing and industrializing economy, potentially exposing it to price manipulation and/or future reductions in supply. A combined Rio and BHP would have accounted for around 40% of the iron ore exported globally, and the bulk of both companies’ seaborne iron ore traveled from their mines in Australia to China and East Asia. Just one other company, Brazil’s Vale, held an additional 30% of the market share at the time. Thus, while China was not the only country showing concern over the potential anti-competitive implications of the tie-up, it was likely to be the most directly affected buyer of seaborne iron ore.
Chinese regulators could review the deal, but because Chinese assets were not being acquired as part of the transaction, a ruling by these regulators would be difficult to enforce without cooperation from the companies involved.

And so, in the early hours of February 1, 2008, the Chinese government-owned Aluminum Corporation of China (Chinalco), in conjunction with the US aluminum company Alcoa, began purchasing stock of Rio Tinto on the open market in a widely acknowledged effort to block its planned takeover by BHP Billiton. Together, they took an overall stake in Rio Tinto of 9% for $14 billion, paying a premium of 21% over Rio’s stock price, and making a potential takeover by BHP more difficult (Bream 2008; Bream & Smith 2008). No formal statement or diplomatic action was necessary – China accomplished its goal through a quick, targeted financial transaction on the open market. The dawn raid not only halted BHP’s attempt to fully acquire Rio, it also signaled China’s willingness to protect its interests by preventing the acquisition of one company by another company on the global stage.

The market is in many ways the next frontier of strategic interaction for states. When national security is involved, strategic interactions involving cross-border mergers and acquisitions (M&A) can have deep parallels to more traditional inter-state balance-of-power dynamics, yet they are rarely discussed within the context of international relations theory. This book uncovers these parallels and the insights they provide. It examines when, how, and why states intervene in the cross-border M&A of companies to balance against other states in the international system.

**International Finance and International Security**

For decades, the M&A of companies across national borders has acted as a key driver of globalization. This fundamental role within globalization remains the same, despite a natural rise and fall in the number of deals that occur during economic booms and contractions. The general trend among nations has been toward “investment liberalization” (UNCTAD 2016b, 90), and, in many sectors of the economy, from service to consumer goods, cross-border M&A activity now occurs with few impediments beyond those that domestic M&A deals normally face. In other sectors, long identified by states as vital to their national security – such as aerospace and defense, energy, basic resources, and high technology – acquisitions by foreign companies may face greater scrutiny. This is because all states maintain the sovereign right to veto attempts by foreign entities to acquire domestically based companies (in these or any other sector of the
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economy), when they believe the transaction in question poses a risk to national security.

While the resort to formal vetoes of the foreign takeovers of companies is relatively rare,\(^3\) the employment of other means to block or prevent such transactions is not. Indeed, the threat (and use) of domestic barriers to block foreign acquisitions on national security grounds is an increasingly typical phenomenon with which global economic actors must contend.\(^4\) There have been numerous examples in recent years of such barriers being implemented or encouraged at the state level. These have ranged from government actions taken to block or modify specific transactions, to the introduction or fine-tuning of wider legal and regulatory measures designed to generally improve the state’s ability to address the national security issues raised by some cross-border M&A – though it should be noted that the latter move toward greater regulation has often been spurred by the state’s actions in relation to specific transactions and the national debate surrounding these actions.

Some of the most well-known examples of government intervention into cross-border M&A on national security grounds include when the US House of Representatives passed legislation instrumental in getting the China National Offshore Oil Corporation’s subsidiary CNOOC to withdraw its bid for the American-based Unocal Corporation in 2005, and when it passed legislation forcing Dubai Ports World (DPW) to divest the US ports involved in its acquisition of the Peninsular & Oriental Steam Navigation Company (P&O) in 2006. In both cases, Congress cited concerns over the deals’ security implications. Other well-known examples include the 2005 French government decree specifying eleven different strategic sectors it considers vital to national security, making M&A in those industries subject to prior authorization by its Ministry of the Economy. This was largely in response to an unwanted attempt by the American company Pepsi to take over Danone, a French national champion (see Chapter 3). France widened the scope of its list of strategic sectors again in 2014, in order to ensure government approval would be needed before General Electric, another American company, could acquire Alstom, a French conglomerate involved in industries from high-speed trains to nuclear power (see Carnegy et al. 2014; Shumpeter 2014). France even created a sovereign wealth fund (SWF) in 2008, the Fond Stratégique d’Investissement, to help protect its strategic companies from foreign acquisition. Similarly, the Italian government issued a decree in 2011 protecting Italian companies in strategic sectors from foreign acquisition, and also created a state investment fund (the Fondo Strategico Italiano, subsequently renamed CDP Equity) to bolster Italian companies in eight designated strategic sectors and to decrease their...
likelihood of becoming foreign takeover targets. For years, the German government even encouraged a “German solution” to prevent one of its companies, Volkswagen (VW), from becoming the target of a foreign acquirer – fighting a protracted battle with the European Commission over the 1960 “VW Law,” which helped protect it from foreign takeover (Barker 2011; Bodini 2013; Harrison 2005).

Even in the best of economic times, it must be asked whether such government intervention poses a threat to economic globalization, and, more fundamentally, how it is compatible with the liberal economic order on which international security largely rests. The importance of such questions looms even larger in the context of an international economy that is still recovering from the severe dislocation of the global financial crisis, which naturally slowed the level of cross-border M&A activity, and that is just beginning to address other unprecedented events, such as Britain’s 2016 decision to leave the European Union (EU).

**Puzzling Behavior**

Since Bretton Woods, Western leaders have sought to establish an international order founded on economic liberalism and free trade in the hope that increased economic interdependence will decrease the likelihood of future wars and improve the global standard of living. Hence, many see it as odd that the types of domestic barriers to cross-border M&A being discussed here are implemented or encouraged at the state level. Stranger still is that these domestic barriers are often employed against the wishes of corporate shareholders and the advice of economists. Traditional interest group and domestic politics explanations, therefore, cannot account for this behavior, because states often intervene against the parochial interests of companies and other domestic groups on behalf of national security. Thus, the very states that helped found the liberal economic order are taking actions that do not always make rational economic sense to the market, shareholders, or economists. In this case, then, there must be another, more pressing rationale behind such behavior.

Given this context, it is a striking puzzle that states are engaging in this type of behavior not only against their strategic and military competitors, but against their allies as well. France, Germany, Italy, and Spain, for example, have all voiced concern about the acquisition of strategic companies by foreign entities hailing from within the EU. For, while the 2004 European Takeover Directive does much to reduce protectionist measures among its member states, and helps to guarantee the free movement of capital promised in the Treaty on the Functioning of the EU,
it does not strip member states of their rights under Article 65 of that Treaty “to take measures which are justified on grounds of public policy or public security,” including national security, in relation to the movement of that capital across its borders. For example, former French Prime Minister Dominique de Villepin, under President Jacques Chirac, openly supported a policy of “economic patriotism” meant “to defend ‘France and that which is French’ by declaring entire sectors of French industry off-limits to foreigners,” including other Europeans and members of the transatlantic community (Theil 2005). As already mentioned, the scope of this policy was widened under President François Hollande’s government. In the interim, President Nicolas Sarkozy, though generally considered more market-friendly, also clearly supported policies identified with economic patriotism, as demonstrated by the creation of the Fond Stratégique d’Investissement and his efforts to prevent a number of France’s national champions (Aventis, Danone, Alstom, and Société Générale) from being taken over by other European or American companies (see Betts 2010; Puljak 2008). This desire to create and protect “national champions” in sensitive sectors is no longer simply a sign of being “French,” however, as other nations within Europe, such as Italy, Spain, and Germany, have also signaled a preference for domestically headquartered white knights to acquire the susceptible takeover targets in their countries (see Financial Times 2005b).

Why are states that are members of a security community based on economic liberalization and integration willing to engage in this specific form of economic protectionism against one another? The purpose of this book is to solve the riddle of this seemingly contradictory behavior. I argue that the basis for such action may be found in the struggle for economic power among states. While states have largely accepted and adhered to the liberal principle that free trade results in absolute gains beneficial to all states, this particular aspect of inward foreign direct investment (FDI) can have direct consequences for national security and, consequently, remains a last bastion of protectionism even among the most benign liberal states.

Drawing upon the international relations literature on the balance of power among states, I argue that governmental barriers to cross-border M&As are used as a form of non-military internal balancing. This concept refers to those actions that seek to enhance a state’s relative power position vis-à-vis another state through internal means, without severing the greater meta-relationship at stake between them. Unlike soft balancing, non-military internal balancing is classified by both the objectives of state behavior and the type of conduct used to achieve those objectives. The power being balanced is also defined differently from the traditional
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sense of the term. In a world where nuclear power has lessened the rewards of territorial conquest and made great power hot wars less likely, many advanced industrial and industrializing states have less reason to fear that their territorial sovereignty will be jeopardized (Mandelbaum 1998/99; Mueller 1988). At the same time, the expansion of economic globalization has increased the reasons for states to be concerned that their economic sovereignty will remain intact. As a result, states are now as concerned with the economic component of power as they are with its military component, and will seek to balance both appropriately.

This type of non-military internal balancing will take different forms or guises when it is motivated by different factors. Non-military internal balancing through intervention into cross-border M&A may, for example, be unbounded in nature, meaning that the state takes direct action intended to block a specific transaction. Alternatively, such balancing may be bounded, meaning that the state takes direct action to instead mitigate the negative effects of the deal, while still allowing it to occur in modified form.

The puzzle can then be solved if the use of such domestic barriers to block or mitigate foreign takeovers on national security grounds is understood to be primarily motivated by either pressing geostrategic concerns or economic nationalism. In the latter instance, such behavior is evidence of a desire for enhanced national economic power and prestige vis-à-vis other states, friend and foe alike. In the former case, this behavior constitutes a more severe form of non-military internal balancing, which allows states to secure and enhance their relative power for long-term gain, without destroying the greater meta-relationship between the two states in the short run. The exact form that intervention takes, and the motivations behind it, will vary with the nature of the relationship between the countries involved and the exact nature of the threat posed by the transaction in question.

The geostrategic dimensions may also extend beyond industries that are traditionally associated with national security. For example, states may use the terms national security and strategic sector in this context in ways that go beyond the realms, and industries, neorealists and neoliberals might traditionally consider vital to hard power. The French, for instance, originally included the gaming sector on their list of strategic industries, because of its potential connection to money laundering (Buck et al. 2006b), and in the 2010s various groups within the US and China called for the recognition of certain elements of the agricultural sector as essential to critical infrastructure and national security due to concerns over bio- and food security. It may also sometimes seem that states use the types of barriers discussed here selectively, and in a manner...
that can appear both opaque and inconsistent. Yet, once it is determined why states are willing to engage in such ostensibly protectionist strategies in the most unlikely cases (i.e., within security communities founded on economic integration), one should be better able to predict what companies and sectors they will seek to protect, and when.

**Intervention in Empirical Context**

*The US Example*

History is marked by periods of increased government intervention into foreign takeovers on the grounds of national security, and the US provides an excellent example of this phenomenon. Times of heightened security awareness combined with surges in protectionist sentiment – most notably surrounding World War I, World War II, the 1970s, the 1980s, and the post-9/11 period – have corresponded to the implementation of formal government measures to ensure that cross-border M&A does not jeopardize US national security (Graham & Marchick 2006; Kang 1997). The 1917 Trading with the Enemy Act (TWEA) was implemented in response to concerns over German attempts during World War I to conduct espionage and other war-related activities through the takeover of US companies, giving the President new controls and power over US subsidiaries of foreign-owned companies (Graham & Marchick 2006). In 1975, the Committee on Foreign Investments in the United States (CFIUS) was established by Executive Order 11858 in response to mounting concern over a rise in foreign investment from states within the Organization of the Petroleum Exporting Countries (OPEC), which was feared to be politically motivated in the aftermath of OPEC’s 1973–74 oil embargo (see Jackson 2010, 2011b; Kang 1997, 302, 311). Executive Order 11858 gave the new interagency committee, chaired by the Secretary of the Treasury, the “responsibility within the Executive Branch for monitoring the impact of foreign investment in the US, . . . coordinating the implementation of US policy on such investment,” and “review[ing] investments in the US which . . . might have major implications for US national interests.”

Fears over high levels of Japanese investment in the 1980s, combined with concern over the potential Japanese acquisition of sensitive US high-technology companies, eventually led to the 1988 Exon-Florio amendment to Section 721 of the Defense Production Act (DPA) of 1950 (Jackson 2010). This provision provides the US President with the authority and specific jurisdiction to prohibit foreign takeovers deemed to threaten national security when existing laws beyond the
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International Emergency Economic Powers Act (IEEPA) cannot provide for its adequate protection. That same year, Executive Order 12661 amended Executive Order 11858 to delegate the President’s authority to investigate and review such foreign takeovers to CFIUS. By 1992, the Byrd Amendment to the DPA further stipulated that CFIUS be mandated to investigate proposed takeovers in which the acquirer was “controlled by or acting on behalf of a foreign government.”

Since the 2000s, the US has seen a new surge in both intervention and related legislation, and intense media coverage and political debate has surrounded the proposed foreign takeovers of a number of US companies. This surge arguably began when, on June 22, 2005, the majority government-owned China National Offshore Oil Corporation’s subsidiary CNOOC announced its bid to acquire the California-based Unocal Corporation. Extensive national and congressional debate over the sale of one of the largest US oil and gas companies eventually resulted in legislation that left CNOOC with extensive delays and facing the likelihood of further opposition to the deal, effectively giving it little choice but to withdraw its bid. On November 29, 2005, the UAE-based DPW launched its bid for P&O, a British ports operator. Few concerns were raised in Britain, which has close ties with Dubai, and few were expected from the US, an ally of the UAE in the Global War on Terror. Yet the deal, which involved the transfer of five US container ports from P&O to DPW, eventually raised a furor that resulted in a surprising “70% of all Americans . . . opposed” to the transaction (Frum 2006). Faced with the possibility of the deal being blocked, P&O offered to divest the ports in question, and eventually sold them to the American International Group (AIG), allowing them to remain under US control (Wright & Kirchgaessner 2006).

Around that time, the Department of Defense (DOD) also raised concerns over the proposed purchase of the US high-tech network security firm Sourcefire by the Israeli company Check Point Software Technologies (Martin 2006). Check Point subsequently withdrew its bid while it was being reviewed by CFIUS, only “a week before a federal . . . report which insiders say would have blocked the merger on the grounds of national-security interests” (Lemos 2006). In 2006, CFIUS also undertook a retroactive review of a 2005 takeover involving the purchase of a US voting machines firm, Sequoia Voting Systems, by a Venezuelan software company, Smartmatic, due to fears that the company might have ties to the Venezuelan government of Hugo Chávez (Golden 2006). By November 2007, Smartmatic had announced it had sold Sequoia to its American management, in order to avoid having to undergo a full investigation by CFIUS (O’Shaughnessy 2007; Smartmatic 2007).
This surge in concern over such takeovers eventually led to the passage of the Foreign Investment and National Security Act of 2007 (FINSA), which aimed to clarify the foreign acquisition review process in the US and strengthen its protection of national security. Following FINSA, a number of other deals were blocked or mitigated on national security grounds, though only three resulted in a formal presidential veto. For example, in December 2009, the Chinese company Northwest Non-ferrous withdrew its bid for a majority stake in the US mining company FirstGold after CFIUS informed both parties it would recommend the President block the deal, which raised “serious, specific, and consequential national security issues,” including the proximity of FirstGold properties “to the Fallon Naval Air Base and related facilities” (Legal Memorandum 2009; Reuters 2009). The US government was also reportedly concerned that the deal would give China access to the particularly dense metal tungsten, which is used in making missiles (Kirchgaessner 2010). The Chinese company Tangshan Caofeidian Investment Corporation (TCIC) withdrew its planned majority stake in the US solar power and telecommunications company Emcore in June 2010, “in the face of national security-based objections” raised by CFIUS, which may have been related to Emcore’s position as “a leading developer and manufacturer of fiber-optic systems and components for commercial and military use” (Keeler 2010). The takeover of the US company Sprint by Japan’s Softbank was allowed in 2013, but was mitigated (i.e., modified) by CFIUS on national security grounds, as Sprint provides telecommunications services to the US government. Concern was expressed that Softbank might, in the future, use the Chinese firm Huawei – branded the previous year by Congress’ Permanent Select Intelligence Committee as “a threat to US national security” – as a supplier of network components; a concern which arose in part because Clearwire, a company Sprint itself was in the process of buying, already used equipment supplied by Huawei (Kirchgaessner & Taylor 2013; US Congress House 2012). Modifications to the deal therefore included giving the US government veto power over the combined entity’s future suppliers of network equipment (Taylor 2013). It should be noted that CFIUS also successfully mitigated or blocked the foreign takeovers of a number of foreign-headquartered companies on national security grounds. In addition, since FINSA, the US has conducted several retroactive reviews of investments that were not voluntarily filed with CFIUS prior to their completion. In February 2011, CFIUS effectively forced Huawei to divest the computing technology assets it acquired from 3Leaf Systems in May 2010 (see Jackson 2016a; Raice & Dowell 2011). In June
2013, Procon Mining and Tunneling, which is affiliated with the Chinese state-owned enterprise (SOE) Sinomach, announced it would divest its investment in Canada’s Lincoln Mining following a CFIUS review that allegedly raised national security concerns over “the proximity of Lincoln’s properties to US military bases” (Pickard et al. 2013). In 2013, CFIUS also ordered the divestment of the Indian company Polaris’ majority stake in the US firm Identrust, which provided cybersecurity services to banks and the US government (Matheny 2013). Each of these companies voluntarily complied with CFIUS’ recommendations before it became necessary to force a presidential decision on them. This was not the case, however, when one company’s refusal to comply with a CFIUS divestment order resulted in the second formal presidential veto of a foreign investment in US history, and the first veto to be made in twenty-two years. On September 28, 2012, Barack Obama issued a Presidential Order for Ralls, a company owned by two Chinese nationals, to divest its four wind farm sites – located in close proximity to restricted air space in Oregon used for testing drones – to an approved purchaser on the grounds of the national security concerns raised by the deal (see Crooks 2012; Obama 2012).

In December 2016, President Obama also formally vetoed the acquisition of the US business of a German semiconductor company, Aixtron, by an ultimately Chinese-owned fund, Grand Chip Investment, on national security grounds (see Obama 2016). According to a press statement by the US Treasury Department, Grand Chip’s owners had financing from a company owned by the China IC Industry Investment Fund, which is a “Chinese government-supported . . . fund established to promote the development of China’s integrated circuit industry” (US DOT 2016b). The same press release disclosed that the national security concern flagged in the deal “relates, among other things, to the military applications of the overall body of knowledge and experience of Aixtron” in the area of semiconductors (US DOT 2016b). Notably, Germany had already pulled its initial approval of Grand Chip’s purchase of Aixtron in October 2016, and was re-reviewing the deal at the time of the US veto because of the security risk it was believed to pose (see Chazan & Wagstyl 2016).

Less than a year later, President Donald Trump formally vetoed the acquisition of the US company Lattice Semiconductor by Canyon Bridge, an acquisition company whose primary investor was the China Venture Capital Fund (CVCF). The deal had been announced in early November 2016, and it quickly emerged that CVCF was ultimately owned and funded by a Chinese SOE (China Reform Holdings) linked to China’s State Council and intended to “invest in strategic emerging