

# 1 A Theory of Non-Military Internal Balancing

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## Introduction

Why do states intervene in the foreign takeover process even within the context of security communities based on economic liberalization and integration? In this chapter, I resolve this puzzle by recognizing that state intervention into cross-border M&A can be understood as a tool of statecraft. I develop a model that explains when, how, and why states use intervention into foreign takeovers strategically to balance the power of other states.

This chapter has five components. In the first section, I examine the link between *national security and foreign takeovers*, providing a necessary backdrop to understanding how and why intervention into cross-border M&A acts as a tool of statecraft. This part of the chapter outlines how states approach national security in relation to foreign takeovers, the legal and regulatory systems they use for restricting such investment on these grounds, and the common types of national security risks states associate with cross-border M&A. The second section examines the relationship between *economic interdependence and power*, and why the distribution of economic power within the international system matters to states. It looks at the theory behind the potential for increased economic competition among interdependent states, how some states act strategically to exploit economic interdependence to their advantage, and why states might seek to balance rising economic and military powers in the economic sphere. In the third part of the chapter, I provide a detailed outline of my *theory of non-military internal balancing* and how it relates to intervention into foreign takeovers. I also propose a probabilistic theory of when and why states are most likely to use intervention into cross-border M&A as such a tool of statecraft, and examine the different *forms* that such intervention may take in practice. This allows me to offer a solution to the puzzle of why this particular tool of non-military internal balancing is used within security communities. The fourth section then details the hypotheses that underpin my theory, and provides a detailed

overview of the methodology used to quantitatively and qualitatively test these hypotheses throughout the book. I conclude with a brief discussion of the expected results of these tests, and of the significance of these findings.

### **National Security and Foreign Takeovers**

States reserve the right under international law to block foreign investments on national security grounds. This right is part of customary international law and is frequently “recognized in various international agreements, in countless bilateral investment treaties, and in investment chapters of free trade agreements” (Jackson 2013, 7). It is even considered to be the “one notable exception to the open investment policies provided for in the OECD instruments” intended to foster the international liberalization of foreign direct investment (FDI) (Jackson 2013, 7). Thus, despite the overall global trend toward economic liberalization and the reduction of barriers to FDI, this particular right to restrict foreign investment on the basis of national security remains untouched, and its use has surged in recent years (see e.g., Graham & Marchick 2006; UNCTAD 2016b).

#### *National Security: Understandings and Approaches*

For the purposes of this inquiry, *national security* is understood – at its root – to be *that which seeks to maintain the survival of the state and preserve its autonomy of action within the international system*. Yet, few states agree on the exact *scope* of national security in relation to cross-border mergers and acquisitions (M&A), because what it takes to survive and maintain autonomy varies from country to country depending on a number of factors, ranging from a state’s size and resources to its geography and historical context. For example, a 2008 report by the US Government Accountability Office (GAO) examined foreign investment restrictions in eleven countries – Canada, China, France, Germany, India, Japan, the Netherlands, Russia, the UAE, the UK, and the US – and found that each one “has its own concept of national security that influences which particular investments may be restricted” by their governments (US GAO 2008, 3). A 2016 report by the OECD Investment Division that surveyed foreign investment policies related to national security in seventeen countries – Argentina, Australia, Austria, Canada, China, Finland, France, Germany, Italy, Japan, Korea, Lithuania, Mexico, New Zealand, Russia, the UK, and the US – came to the same conclusion (Wehrlé & Pohl 2016, 20–1).

States also have different legal and regulatory approaches to restricting foreign investment on national security grounds. This is due not only to differences in their exact interpretation of the scope of national security, but also to variances in their national legal systems, historical relationships to the market, and “experience with foreign investment” (US GAO 2008, 7). Wehrlé and Pohl (2016) have categorized these investment restrictions into three broad approaches for the OECD, while making it clear that many states utilize a combination of them.<sup>1</sup> The first approach takes the form of “partial or total prohibitions of foreign investment in specified sectors,” which are identified by the state as being integral to national security (Wehrlé & Pohl 2016, 11, 13–14). This approach focuses on the protection and retention of domestic control over what are often called *strategic* or *national security* sectors. The specific industries identified as being strategic vary from state to state, but there are naturally areas of common concern around sectors like aerospace and defense, high technology, and scarce resources. The second approach is for a country to review all proposed investments that fall within certain “legally defined” categories (Wehrlé & Pohl 2016, 11, 14). The criteria used to delineate these categories usually involve thresholds around the monetary value of an investment, the sector involved, and/or the percentage stake sought in the domestic entity (US GAO 2008). The third approach involves “scrutiny systems that identify individual, potentially problematic transactions,” and then subjects these transactions to review (Wehrlé & Pohl 2016, 11).<sup>2</sup> In the chapters that follow, I focus primarily on the actions undertaken by states as a result of the review and scrutiny of FDI (the second and third approaches), rather than through partial or blanket sectoral prohibitions (the first approach). For, it is through these former approaches that decisions about individual investments are *actively* taken by a state in relation to a particular foreign investment, and the outcome of that proposed investment is not pre-determined.

Most states are unwilling to explicitly define their understanding of the term “national security” in relation to this type of foreign investment, in order to maintain the flexibility needed to respond to the evolving and context-dependent nature of the threats such transactions might pose. Some states may even use different terminology, referring instead to the need to protect the *public order*, *national defense*, or the *essential security* of the state – though these terms encompass national security (US GAO 2008, 8; Wehrlé & Pohl 2016, 20–1). Instead of defining national security (or its surrogate terms), states tend to offer a vague “clarifying definition,” “a list of national security relevant sectors given as examples,” or a discussion of potential illustrative “threats to national security” (Wehrlé

& Pohl 2016, 20–1).<sup>3</sup> Despite this ambiguity, some common themes, concerns, and perceived risks are identifiable (Jackson 2013; US GAO 2008; Wehrlé & Pohl 2016).

*National Security Risks and Cross-Border M&A*

The US, once again, provides a useful starting point for understanding the nature of the national security concerns that can be raised by foreign takeovers. Despite the classified and confidential nature of individual FDI reviews, the US scrutiny system for vetting foreign takeovers (the Committee on Foreign Investments in the United States, CFIUS) is arguably among the most transparent and institutionalized in the world, and has been written about the most from theoretical, legal, and informational perspectives. And while the US does not define national security for the purposes of foreign investment screening, it does provide an “illustrative,” though not exhaustive, list of the types of “national security factors” the President and CFIUS might take into consideration when assessing whether or not a particular foreign merger or acquisition “poses national security risks” (73 FR 74569). These risks factors are outlined in Section 721(f) of the Defense Production Act of 1950 (DPA) as amended by the Foreign Investment and National Security Act of 2007 (FISIA), codified at 50 U.S.C. App. 2170.<sup>4</sup> They include the potential national security effects of a specified transaction on:

- domestic production needed for projected national defense requirements,
- the capability and capacity of domestic industries to meet national defense requirements, . . .
- the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security, . . .
- sales of military goods, equipment, or technology to any country . . . that supports terrorism; [is] . . . of concern regarding missile proliferation[, nuclear proliferation, or] . . . the proliferation of chemical and biological weapons; [or] . . . is identified by the Secretary of Defense as posing a potential regional military threat . . .
- United States international technological leadership in areas affecting United States national security; . . .
- critical infrastructure, including major energy assets; . . .
- critical technologies; . . .
- the long-term projection of United States requirements for sources of energy and other critical resources and material; and
- such other factors as the President or the Committee may determine to be appropriate, generally or in connection with a specific review or investigation. (50 U.S.C. App. 2170(f))

This list also includes an assessment of whether or not the transaction is “foreign government-controlled” (50 U.S.C. App. 2170(f)), in the sense that it could lead to “the control of a U.S. business by a foreign government or by an entity controlled by or acting on behalf of a foreign government” (73 FR 74569). If so, or where otherwise appropriate, an assessment is also made of additional risk factors surrounding the country from which the investment ultimately originates, namely: (A) whether or not it adheres “to nonproliferation control regimes”; (B) “its record on cooperating in counter-terrorism efforts”; and (C) whether the transaction could possibly lead to the “transshipment or diversion of technologies with military applications” away from the US, requiring an examination of that country’s “national export control laws and regulations” (50 U.S.C. App. 2170(f)).

Even as an arguably benign liberal hegemon, the US recognizes the need to maintain its global technological (and thus military) advantage by pursuing economic policies that foster the health of the defense industrial base, prevent its control by foreign governments, and ensure technology shared with its closest allies is not exported to unfriendly regimes. Undergirding this strategy are the institutions that allow the US government to mitigate or block those foreign mergers or acquisitions it believes to be threatening to national security.<sup>5</sup> As the dangers emanating from such deals are numerous, and the risk factors just enumerated can encompass a wide array of specific activities by a foreign investor, it is worth also highlighting those national security threats that Graham and Marchick (2006) have identified as being the ones CFIUS frequently considers when assessing a potential foreign takeover in the US. These include a number of specific actions foreign investors might possibly take:

shutting down or sabotaging a critical facility in the United States; impeding a US law enforcement or national security investigation; accessing sensitive data . . . ; limiting US government access to information for surveillance or law enforcement purposes; denying critical technology or key products to the US government or industry; moving critical technology or key products offshore that are important for national defense, intelligence operations, or homeland security; unlawfully transferring technology abroad that is subject to US export control laws; undermining US technological leadership in a sector with important defense, intelligence, or homeland security applications; compromising the security of government and private sector networks in the US; facilitating state or economic espionage through acquisition of a US company; and aiding the military or intelligence capabilities of a foreign country with interests adverse to those of the United States.<sup>6</sup> (Graham & Marchick 2006, 54)

Though both their list and the list provided in the amended DPA focus specifically on US security, they illustrate the types of national security risks that would be of valid concern to almost any country.

Most of these concerns emanate from a state's fear that another state will seek to gain influence over one of its corporations in order to enhance its position and power within the international system. As Graham and Marchick (2006, 54) point out, such predatory behavior may include a foreign government using its influence to encourage one of its domestic companies to acquire a foreign company for the purpose of engaging in espionage.<sup>7</sup> Even worse, a state might endeavor to acquire a vital component of another country's defense industrial base, which it could then destroy, hijack, or generally use to its advantage. The Chinese government, for instance, has a reputation for trying to buy foreign companies in order to acquire military technology through espionage (Graham & Marchick 2006, 112–13; Interview 2007). Not surprisingly, this behavior has affected the reception of Chinese takeover bids within the US (Graham & Marchick 2006, 112–13; Interview 2007).<sup>8</sup> Indeed, the only four foreign acquisitions to be *formally* vetoed by a US President (since the Exon-Florio legislation that originally enabled a president to do so)<sup>9</sup> involved Chinese investors. The first was a Chinese government-owned company (CATIC) that sought to take over a US aerospace components manufacturer (MAMCO) in 1990.<sup>10</sup> The second was when, in 2012, the US President ordered a company owned by Chinese nationals (Ralls) to divest four wind farm site assets located in close proximity to restricted military air space (see Obama 2012). The third was when the President vetoed the acquisition of the US business of a German semiconductor company (Aixtron) by a Chinese-owned investment fund (Grand Chip) over concerns that Aixtron possessed sensitive technology with military applications and that Grand Chip's bid involved financing supported by the Chinese government (US DOT 2016b). The fourth was when the President vetoed the acquisition of the US-based Lattice Semiconductor by a company (Canyon Bridge) ultimately owned and funded by a Chinese SOE directly linked to China's State Council over a series of national security concerns relating to the Chinese government's involvement in the deal, as well as the technology involved, its use by the US government, and concerns over its continued supply (Baker, Qing, & Zhu 2016; US DOT 2017).

Another common concern among many countries is that a state, through entities it either owns or influences, may endeavor to acquire foreign companies in order to increase its control over a valuable resource. Such control could enhance that state's position within the international system by increasing its influence over the behavior of those states that

need the resource in question, and which fear an intentional disruption of its supply. The behavior of the Russian government in recent years, which suggests an effort to increase its control over the oil and natural gas industries within Europe in order to augment its influence in the region, illustrates this point well.<sup>11</sup>

These are but a few examples of the national security concerns states might have in the context of foreign takeovers. One of the reasons the US list is so useful and instructive for understanding the common concerns states may have is that it is rare for states to provide such a rich and detailed set of examples.<sup>12</sup> Other countries, when they bother to do so at all, tend to offer more limited examples, but they *do* often exhibit similar concerns, even though these might be worded differently or use different terminology. The 2016 OECD report, however, offers some examples of factors raised by other countries that are not explicitly covered in the US list. For instance, while the US highlights an investing country's relationship with terrorism as a potential risk, other countries – like France, Italy, Lithuania, and New Zealand – also look at the risk from “investments by persons linked to organised crime, . . . or other criminal activities” (Wehrlé & Pohl 2016, 21). Italy considers “investments from foreign countries that do not respect democracy and the rule of law or have held conducts at risk towards the international community” to pose a security risk (Wehrlé & Pohl 2016, 21). Perhaps more controversially, some countries – like Australia, China, Japan, and New Zealand – highlight concerns regarding “the impact of the investment on the economy” as being among their national security considerations (Wehrlé & Pohl 2016, 21).

The scope of national security as it relates to FDI will thus vary in accordance with the different threats individual states perceive to their survival and autonomy within the international system. For example, not all governments (or theorists) will necessarily feel comfortable with the inclusion of a foreign investment's impact on the host economy within the remit of national security considerations. However, if a country defines this particular concern publicly as being within the scope of its national security, and then cites a specific foreign investment as being a *national security* concern for this reason (rather than a *national interest* concern, which might be more closely identified with the language of traditional economic protectionism), then it will be accepted as a national security concern for the purposes of this book. Defining the exact scope and parameters of “acceptable” or “valid” national security concerns is beyond the book's remit, and should be the subject of a separate inquiry. It is also true that, in rare instances, state officials might use the term “national security” instrumentally (or even

inappropriately) in the context of FDI, in order to achieve goals other than balancing. I have therefore assessed the national security grounds cited for intervention (if specified)<sup>13</sup> in the cases examined in this book, and have attempted to judge, fairly and without prejudice (insofar as this is feasible), whether the risk cited is in line with a given country's historical approach to national security.

### **Economic Interdependence and Power**

Overall, the types of common national security concerns discussed in the previous section have one clear thing in common. They imply that the state on the receiving end of a particular cross-border merger or acquisition (the target state) believes that the state of the acquirer (the sending state) could be placed at an advantage in terms of military or economic power as a result of that proposed deal, and thus that the transaction could be detrimental to them, the target state. Whether or not the sending state actually intends (or is believed to intend) harm will thus have a great effect on how the government of the target state responds to the proposed transaction.

Clearly, some states *do* seek to take advantage of the interdependent relationships that arise from globalization, in order to increase their economic and military capabilities relative to others. This notion is well documented (Gilpin 1981, 1987, 2001; Hirschman 1945; Moran 1993; Shambaugh 1999; Tyson 1992; Waltz 1993, 1999). And though most theorists of economic interdependence deal with the dependencies that result from foreign trade, rather than FDI, it is a reasonable assumption that these dynamics may be applied to the latter.<sup>14</sup> According to these theorists, states will have different levels of "sensitivity" and "vulnerability" as a result of a mutually dependent relationship, where sensitivity implies that a state *A* can suffer the negative effects of the actions of another state *B* "before policies are altered to try to change the situation," and vulnerability implies that state *A* can be negatively affected by the actions of state *B* "even after policies have been altered" (Keohane & Nye 1989, 13).<sup>15</sup> Hirschman's systematic examination of such phenomena demonstrates not only that "international trade might work to the exclusive or disproportionate benefit of one or a few of the trading nations," but also that states may abuse their position in an asymmetrical trading relationship (Hirschman 1945, 11). He makes the important point that enhancing a state's economic power does "not necessarily lead to an increase in relative power," or "a change in the balance of economic power in favor of any particular country," *unless* states pursue policies that enhance the dependencies of other



states on that relationship (Hirschman 1945, 9).<sup>16</sup> As some countries do pursue such policies, states consequently remain concerned with the relative distribution of the gains from trade, even though liberal theorists since Adam Smith have demonstrated the absolute gains to all involved (Hirschman 1945, 5–6; Keohane & Nye 1989, 10; Waltz 1979, 140–3).

States are thus highly likely to focus on the relative distribution of economic power within the international system.<sup>17</sup> This is especially true in an environment where the likelihood of a major power hot war is low (Mandelbaum 1998/99; Waltz 1993) and hard power within the system must be increasingly gained through non-military means.<sup>18</sup> States will therefore seek to increase their economic power, which not only benefits their own domestic economy, but also provides absolute gains to their trading partners, and hopefully increases their ability to influence others by enhancing either their position of dominance or the dependence of other states on their economic policies.<sup>19</sup> As a result, “economic competition” will in all probability “become more intense” (Waltz 1993, 59).

A state will thus feel insecure as another state gains economic power relative to it and will seek to *balance* that rising economic power. Similarly, one state may seek to balance another if the latter attempts to make the former dependent upon it in some way through FDI. When international relations theorists refer to the US backlash against Japanese investment in the 1980s, there is an assumption that this is what occurred. Waltz claims that once Japan recovered from World War II, the US “objected more and more strenuously” to its “protectionist policies” as its economy developed into that of a rising power with a “strategy of ‘creating advantages rather than accepting the status quo’” (Waltz 1979, 7–8). In 1991, Borrus and Zysman suggested that Japan and Europe were both pursuing policies to protect their technological industrial bases from foreign acquisition as part of internal balancing strategies meant to create an eventual advantage over the US (Borrus & Zysman 1991, 25, 27). The following year, Tyson strenuously argued for FDI policies that would protect American interests from such Japanese tactics (see Tyson 1992). Graham and Marchick then made a similar argument about the current US backlash against Chinese and Middle Eastern investment in 2006. They asserted that if “the US in the past has sought to protect itself from FDI originating in Germany and Japan,” then “today, similar sentiments are harbored toward Middle Eastern countries for their supposed links to terrorist activities, but more importantly towards China, which, as a vast and growing economy, could one day challenge the US in economic might” (Graham & Marchick 2006, 94). Such an attitude,

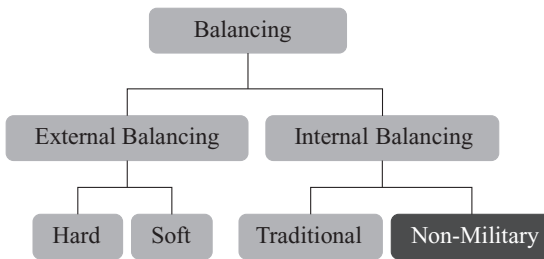
they believe, can explain US intervention in the Dubai Ports deal and CNOOC's attempt to buy Unocal.

## The Theory

### *Non-Military Internal Balancing and Foreign Takeovers*

I believe government intervention into foreign takeovers of companies on national security grounds should thus be understood to be a form of *non-military internal balancing*, which is primarily motivated by either economic nationalism or pressing geostrategic concerns. This theory begins from neorealist assumptions about the structural dynamics of the international system and its general effect on state action. Yet, as structural realism alone cannot provide the full solution to our puzzle, it is also necessary to include certain domestic-level variables, such as the presence of economic nationalism, in our investigation.

This combination of domestic and structural variables with a primary focus on the structure of action can be likened to a neoclassical realist approach. Neoclassical realists “argue that the scope and ambition of a country’s foreign policy is driven first and foremost by its place in the international system and specifically by its relative material power capabilities” (Rose 1998, 146). Yet, they also believe “that the impact of such power capabilities on foreign policy is indirect and complex, because systemic pressures must be translated through intervening variables at the unit level” (Rose 1998, 146). It is for this reason that neoclassical realists, such as Schweller, Wolforth, and Zakaria, examine both domestic and system-level variables to explain foreign policy outcomes (Lobell et al. 2009, 20). Such theorists build on both the insights of structural realism, because of its appreciation of systemic pressures placed upon state actors, and classical realism, because it recognizes “the complexity of statecraft” (Lobell et al. 2009, 4). Importantly, these theorists demonstrate that the “‘transmission belt’ between systemic incentives and constraints, . . . and the actual diplomatic, military, and foreign economic policy of states” is “imperfect” (Lobell et al. 2009, 3). Schweller, for example, has used domestic political variables to explain why, within the context of balance of power theories, states might *underbalance* a rising threat. In other words, the neoclassical realist understands that “decision makers are not sleepwalkers buffeted about by inexorable forces beyond their control” but actors who “respond (or not) to threats and opportunities in ways determined by both internal and external considerations of policy elites who must reach consensus within an often decentralized and competitive political process” (Schweller 2004, 164). They

**Figure 3 Modes of balancing**

recognize that international relations is a two-level game (Putnam 1988), and believe that an examination of the domestic variables that motivate states to recognize, and implement, structurally demanded strategies should not be degrading to realist theory, but should instead contribute to its progress in the Lakatosian sense (Lobell et al. 2009, 21).<sup>20</sup>

The theory presented in this book begins from the structural realist assumptions that states are the primary actors<sup>21</sup> in an anarchic international system and that, as such, they must rely on themselves to provide for their own security and survival (Waltz 1979, 88–93). This focus on survival within the context of a necessarily “self-help system” causes states to be concerned with the relative distribution of power, defined primarily on the basis of “capabilities” (Waltz 1979, 97–9, 129). As a result, states will seek to maintain or maximize their power relative to that of others, either when threatened (Walt 1987)<sup>22</sup> or when their relative power is challenged by an actual and unfavorable change in the distribution of capabilities (Waltz 1979, 118). According to Waltz, a state may balance the relative power of another either *externally*, through “moves to strengthen and enlarge one’s own alliance or to weaken and shrink an opposing one,” or *internally*, through “moves to increase economic capability, to increase military strength, [and/or] to develop clever strategies” (Waltz 1979, 118) (see Figure 3).

Government intervention into cross-border M&A can thus be understood to be a tool of *internal balancing*. It can certainly be part of an effort to preserve or enhance domestic economic capability and/or military strength, when the outright takeover of a particular domestic company challenges, or threatens to alter, the state’s relative possession of those capabilities. For, states may use intervention to protect companies (or some of their assets and capabilities) from foreign control, when that control is sought for purposes that would prove detrimental to state security. States may, for example, attempt to block or alter a foreign takeover

in order to preserve (and sometimes further) technological and industrial advantages that are vital to their military power, or to the resources necessary for their continued existence. Similarly, states have also used intervention to protect national champions deemed vital to their economic power and position. It will be demonstrated in the chapters that follow that most examples of government intervention into foreign takeovers on national security grounds, and in the sectors commonly associated with national security examined in this book, are acts that seek to maintain or maximize the economic and/or military power of the state in response to a threat or challenge to that power posed by the takeover. In other words, the form, intent, and purpose of such interventions are clearly consistent with those of internal balancing, as it is traditionally understood.<sup>23</sup>

The scope of Waltz's definition of internal balancing is indeed wide enough to encompass such government action. For, though many scholars have come to simplify the definition of the term to refer only to the mobilization or enhancement of arms and other military capabilities,<sup>24</sup> the economic element should not be forgotten, especially as it is often integral to the success of the defense industrial base that oils the machine of war. In an effort to further specify the role of economic policy in balancing, Brawley argues that there are clearly separable economic and military components of both internal and external balancing (in Paul et al. 2004).<sup>25</sup> Though his discussion of the economic component of internal balancing revolves primarily around basic trade and financial aid strategies, there is no reason why it might not include strategies for dealing with FDI in sensitive industries or companies of the type examined here. Borrus and Zysman, for example, have claimed that Waltzian internal balancing can be synonymous with "positive industrial adjustment" of the type used by states to gain a competitive economic and military advantage in terms of technology, which they mention can – beyond the trade and industrial policies usually discussed in that context – involve policy that either prevents foreign acquisitions in some sectors or places "local content requirements" on other forms of FDI (Borrus & Zysman 1991). There is thus some precedent for the argument that the behavior examined in this book can act as a type of internal balancing.

Furthermore, I argue that state intervention into foreign takeovers acts – more particularly – as a form of *non-military* internal balancing. Here, the strategy still involves strengthening military and/or economic capabilities, but also has two important non-military elements. First, the tool is clearly one of policy and action that occurs within the context of the economic realm. Second, non-military internal balancing involves *actions that seek to enhance a state's relative power position vis-à-vis another state, or states, without severing the greater meta-relationship at stake between*

*those states*. The goal is still to balance a challenge or threat to power through non-military and internal means, but, unlike Brawley's concept of the economic component of internal balancing, *non-military internal balancing* is classified by this additional *objective* of state behavior, as well as by the *type of conduct* used to achieve those objectives.

It is also important here to clearly differentiate *non-military internal balancing* from *soft balancing*, as some important distinctions exist between these two concepts (see Figure 3). First and foremost, non-military internal balancing is a strategy that may be employed by both hegemonic and weaker powers, whereas soft balancing is usually defined as a policy tool that is only used *against* a hegemon (see Pape 2005; Paul 2005; Walt 2005). This is because much of the literature on soft balancing arose out of a desire to explain why states in the post-Cold War period had not formed a countervailing military coalition against US hegemonic power in the way many international relations theorists expected, as well as to categorize the non-military and non-traditional efforts of many states to constrain (or restrain) US unilateralism in the wake of 9/11.<sup>26</sup> These theorists believed "it was a mistake" for structural realists "to expect 'hard balancing' to check the power of the international system's strongest state" after the end of the Cold War because in a unipolar system, "countervailing power dynamics [would] first emerge more subtly in the form of 'soft balancing'" (Brooks & Wolforth 2005). Nye, however, has made a compelling case that while the world might be unipolar in the military realm (and this itself may be changing, with the rise of Russian and Chinese forces in recent years), it is clearly multipolar in the economic one (Nye 2002, 39). If one accepts this, then traditional methods of internal balancing are even more likely to occur in the economic realm than soft balancing theorists currently recognize, and, more importantly, a military hegemon may engage in the same type of non-military internal balancing behaviors as weaker states. This is clearly the case now, as the US seeks to preserve its relative power position through non-military internal balancing against rising powers, just as Italy or Russia might use similar techniques to enhance its own position.

Second, most definitions of soft balancing are based on the policy *tools* states employ, rather than on the policy *objectives* they seek (as with Brawley's concept of the "economic component" of internal balancing). Paul, for example, defines soft balancing as "tacit balancing short of formal alliances . . . often based on a limited arms buildup, ad hoc cooperative exercises, or collaboration in regional or international institutions" (in Paul et al. 2004, 3). This explains why theorists like Pape (2005) argue that such strategies could eventually lead to hard balancing in the future.

The concept of non-military balancing, however, is defined by its *ends* as well as by its *means*. Finally, only a few soft balancing theorists even mention that the use of economic tools might be part of an act of soft balancing (see e.g., Pape 2005; Paul 2005; Walt 2005), and even fewer provide rigorous empirical testing of their claims regarding the economic forms of soft balancing. Thus, while non-military internal balancing might be used in tandem with soft balancing under certain circumstances, it must be clearly differentiated from that concept.

Government intervention into foreign takeovers acts as an excellent form of *non-military* internal balancing because it allows states to provide for their long-term security in a way that takes full advantage of their present power position *without* causing them to engage in activities that are viewed as inherently confrontational.<sup>27</sup> States are therefore able to both “maximize value in the present” and “secure their future positions” through economic competition (Waltz 1993, 63), without other states necessarily perceiving that build-up as being targeted against them. Again, this is especially relevant in an international environment where the inter-state use of force is less acceptable. It also helps to explain why *allies* might engage in such a form of balancing against one another, i.e., this strategy allows states to jostle for position within an alliance, as well as to provide for their long-term security should the strength of the alliance eventually deteriorate.<sup>28</sup> This is because there is a prevailing perception that, while states intervene in foreign takeovers for the “high politics” reason of national security, the act and its effects occur in the “low politics” realm of bureaucrats and businessmen.<sup>29</sup> This perception can, in many cases, actually help the state to maintain valuable relations with the other country involved in the transaction. For, even when heads of state do become involved in a foreign takeover process, the professed desire to protect companies, resources, and technology deemed vital to national security is so old and inherent that it is rarely taken “personally” by other states. On the rare occasion that the acquiring company’s host state is offended, its government may find it difficult to express such offense at the official level without risking constraining its own future breadth of action.<sup>30</sup>

Government intervention into foreign takeovers also serves as a highly *flexible* tool for non-military balancing, because of the numerous forms it can take. For, though *formal* government vetoes of foreign takeovers are the most well-known form of intervention, they are also the rarest. Instead, interventions usually tend to range from alterations to the deal (mitigation measures) that allow the host state of the target company to retain control over its domestic security, to informal government intervention that causes the acquiring company to withdraw voluntarily from

the process in order to save “face” or money. Thus, many forms of intervention do not, on the surface, appear to “block” a deal, nor do they make it look as if a government has taken negative action against another state. Instead, its action is cloaked within the deal process. This assuages negative feelings between both countries and helps preserve the relationship between them, while still allowing one state to pursue a gain in relative economic power. It also permits governments to preserve their relative economic and military power vis-à-vis another state by helping them maintain domestic control over those industries, resources, and companies that they consider vital to national security.

While these arguments explain why states balance economic power through a strategy of non-military internal balancing, they do not necessarily answer the puzzle of why governments would treat members of their own security community in the same way as those outside of that community. For, though it may be obvious to a realist why America would choose to balance a rise in Chinese economic power, the motivations behind a European state’s desire to balance the rise in economic power of another European state (within the context of both an economic and a security community) are not as obvious. As mentioned earlier, structural realism does not account for why a state would engage in such behavior against its military allies, or how that balancing of economic power might vary according to motivation and context.

The rest of the theory presented here attempts to resolve these issues by arguing that the answer lies in the *form* of government intervention that non-military internal balancing takes, which will vary in accordance with its primary motivations. A probabilistic theory of intervention (laid out in the next section) is followed by an examination of the possible solution to the puzzle, and later by the hypotheses that will be examined in this study to verify the soundness of that argument.

### *A Probabilistic Theory of Intervention*

Before moving to the solution of the puzzle, it is necessary to first provide a general and probabilistic theory of when and why governments are likely to intervene in foreign takeovers on national security grounds. As mentioned already, non-military internal balancing is primarily motivated by either geopolitical concerns or economic nationalism. However, alternative explanations must be controlled for, including economic and interest group arguments. Thus, the principal hypothesis examined in this book is that an individual government’s use of domestic barriers to foreign takeovers of companies on national security grounds depends on (1) the geostrategic implications/concerns raised by the potential

takeover and (2) the level of economic nationalism in the target company's home state, controlling for (3) the economic competition concerns raised by the potential takeover and (4) the presence of interest groups that oppose the acquisition of the target company and have access to power in the home state of that company.

The use of case studies allows for a detailed exploration of the various nuances and different dimensions of these variables. Toward this end, the following definitions were used in the investigation of the case studies, though narrower ones were necessary for the purposes of the statistical investigation of this hypothesis, as discussed in Chapter 2.

The presence of *geopolitical competition* between states will be determined qualitatively on the basis of three factors. The first will be the degree to which the *character of the political relationship* between the countries involved in the transaction is positive or negative. In other words, are the two countries formal military allies? If so, are they members of the same security community? Does the potential for strategic competition exist between those countries? Even if states *A* and *B*<sup>31</sup> are allies, is there a prevailing perception within state *A* that state *B* is a threat? The second factor is the degree of *resource dependency* between states *A* and *B*. In other words, what is the general level of state *A*'s dependence on trade to obtain basic resources such as oil, natural gas, and water? Furthermore (to the extent that information is available), what is the specific level of state *A*'s dependence on state *B* for these resources? The third factor is the differential in *relative power* between the two states involved in the transaction. Is the host state of the acquiring company a major power? Is the host state of the target company a major power? Is state *B* rising in relative economic power to state *A*? Is it increasing in military power?

The presence of economic nationalism in state *A* will be determined on the basis of three factors. The first will be the level of national pride that the populace of state *A* professes to have. The second will be the level of anti-globalization sentiment within the populace of state *A*. The third will be the level of domestic support for companies that are considered "national champions." In other words, is the target company often referred to in public parlance as a "national champion"? Does state *A* demonstrate support for national champions in other cases?

The remaining variables represent two possible alternative explanations of government intervention for which this study will need to control. The first is that the specific form of economic protectionism being examined here may be explained by the presence of interest groups pressing for governmental intervention. The case studies will, therefore, seek to identify the presence of individual pressure groups that were involved in the process, and determine their effectiveness in changing the policy of the government in question vis-à-vis the potential takeover.



I expect to find, however, that while interest groups may raise the awareness of state *A* regarding national security issues raised by state *B*'s involvement, or company *Z*'s behavior, this is unlikely to be the *cause* of intervention. In other words, *states will tend to formally intervene (either to block or alter a deal) only when national security issues are actually present, because of the reputational concerns involved.* If we look to the US, for example, it seems that while there is occasionally evidence of a pressure group raising the government's awareness of a deal, once that awareness is raised, pressure groups are largely kept out of the process.<sup>32</sup> As governmental decisions in this area seem to fly in the face of interest group pressure as often as they agree, the results of the hypothesis testing are expected to show little or no correlation to this variable.

The second alternative explanation for government intervention is that the merger or acquisition was blocked on the basis of competition concerns raised by either the host state of the target company, the host state of the acquiring company, or a relevant regional economic authority, such as the EU Commission. Each case will be examined to see if the relevant state (or regional) authority raised competition concerns. This variable is included in the case studies as a control variable, because of the possibility that government review of a given deal might be precluded by a decision that the takeover should be blocked on competition grounds.

It should be noted that other alternative independent variables were considered during the formative stages of the theory presented here. These ranged from additional domestic politics variables, such as the role of *electoral politics* and *racism* in government interventions, to the presence of *competing bidders* and some of the potential *ownership structures* of the acquirer involved in individual transactions. As my aim is to create as parsimonious a theory as possible on a complex subject, I ultimately decided not to include these variables, which in preliminary testing and research proved insignificant across the body of cases and whose inclusion, even as controls, did not appear to improve the explanatory power of the case studies or the fit of the statistical model. (For further discussion of these variables, and why they were not included in the final hypotheses tested, see Appendix A.)

If the sole purpose of this inquiry were to predict the likelihood of intervention in any one particular case, it would be necessary to formulate my argument differently. For instance, Grundman and Roncka have created a comprehensive "risk assessment matrix" to help determine the chances of a US government intervention into a given cross-border merger and acquisition (Grundman & Roncka 2006, 8). They suggest twenty possible variables that might affect a company's chance for survival of the government review process. To name but a few, these

include general economic and political variables such as: whether or not the deal is “beneficial to current US customers”; the “viability of current US ownership”; the “amount of media coverage”; and the “lobbying strength of competing bidders” (Grundman & Roncka 2006, 8). Others are focused on how the deal affects the health of the defense industrial base, including: the benefit to the US in terms of the “net technology transfer”; the “requirement for interoperability with the US”; whether or not the “target firm’s business” is “commercial” or “defense” related; and whether the target’s “level of classification” is “unclassified” or one of “special access” (Grundman & Roncka 2006, 8). Additional variables focus on the national security concerns germane to this inquiry, namely: whether or not the “partner country is [a] US ally”; the degree of “foreign ownership,” or “foreign government ownership” or “influence”; whether or not the host state of the acquiring company (or the company itself) has “ties to ‘unfriendly’ entities”; and the degree to which the “political climate” is “hostile” to the deal (Grundman & Roncka 2006, 8). Clearly, checking off every item on this extensive list of factors is vital for companies engaging in the US review process.

The goal of this book, however, is to offer a theory that is both parsimonious and generalizable, rather than one that is deeply US (or case) specific. Thus, while it is necessary to draw on the work of analysts like Grundman and Roncka, it is also important to ascertain whether or not some of the specific variables they examine might fit into broader categories, or drop out all together. It must be stressed again that the purpose here is to delineate *probabilistic tendencies toward state intervention across countries, cases, and time*. I recognize that states, and the bureaucrats within those states who deal with these issues on a daily basis, approach each foreign takeover as an individual case, and may not even be cognizant of the overarching tendencies in their behavior. I also recognize that many different actors – from bureaucrats and parliamentarians to heads of government – ultimately contribute to a state’s final position or stance regarding intervention, and thus all relevant government actors are examined in each case studied in this book.<sup>33</sup> Yet, what is ultimately being investigated here is how the environment in which states must act, on the whole, structures the action of those states in each case, given the presence of the variables outlined in my hypothesis.

### *The Solution to the Puzzle*

Such a probabilistic theory of intervention alone cannot explain the puzzle of why states utilize domestic barriers to foreign takeovers of

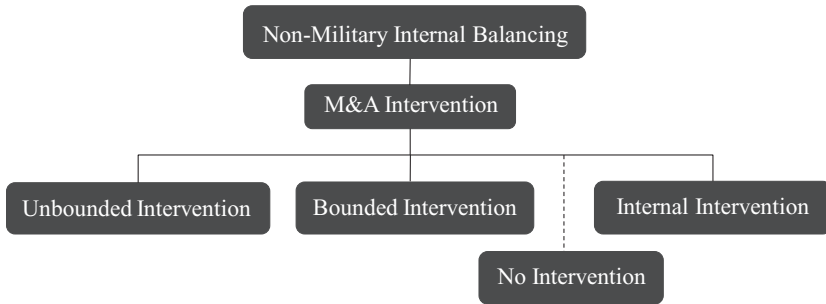
companies in national security industries, even within security communities founded on economic liberalism and integration.

One way to solve the puzzle is to argue that not all forms of non-military internal balancing through government intervention into M&A on national security grounds can be considered equal. Rather, as in all forms of balancing and power competition, there are variations on the theme that can achieve the same desired effect. State *A* may thus be able to ensure the protection of its national security, and even preserve its long-term power objectives relative to state *B*, by simply altering or mitigating the effects of an M&A deal in some way. This is a more likely option among close allies, especially where some degree of integration of the defense industrial base is preferable, because it widens the scope of competition and enhances opportunities for the development of new technologies, while likely lowering prices. Thus, while governments *will* intervene in cross-border takeovers by allies, that intervention may be more likely to lead to a “changed” deal that protects national security, rather than a “blocked” deal.

Most instances in which deals are blocked will result from geostrategic concerns that arise between countries that are either not allied, or between whom there have arisen issues of trust despite the existence of an alliance relationship. It must be noted that there are examples of even the closest of military allies finding that companies within their state (which they may or may not be connected to) are having their proposed takeovers “effectively” or formally blocked. I argue that this can occur when the host state of the acquiring company, or the acquiring company itself, is viewed as significantly threatening. Some flexibility is required in determining what poses a significant enough threat to lead to a breakdown in trust between two countries; it could range from fears of espionage to a negative perception of the other state arising from actions in the realm of national security, despite the existence of a formal military alliance between those states. As one source within the legal community has pointed out: “there are allies, and there are allies” (Interview 2007). Which “friends” are the most trusted, and in what areas they are trusted, soon becomes quite clear to those looking at government intervention into cross-border M&A.

#### *Forms of M&A Intervention as Non-Military Internal Balancing*

I argue that government intervention into cross-border M&A can be considered to take three possible forms, which are classified here as *unbounded*, *bounded*, and *internal* intervention (Figure 4). Each of these forms is defined in this section, as are the conditions that may allow

**Figure 4 Types of M&A intervention as a tool of non-military internal balancing**

a deal to proceed with little or no intervention. However, in most of the sectors considered by states to be integral to national security, it is extremely rare for a deal not to face some level of mitigation or alteration before it is allowed to go through.

### Unbounded Interventions

Unbounded interventions are those in which the intended result of government intervention is the formal, or effective, block of a cross-border merger or acquisition as a consequence of stated concerns regarding national security. A “formal block” occurs when the government, or one of its representative agencies, announces that a deal has been vetoed on national security grounds. An “effective block” occurs when the acquiring company withdraws or rescinds its proposed bid for the target company as a result of one or more of the following actions:

1. The government (and/or its agencies) voices such significant concerns or reservations regarding the deal before the formal review process begins that the acquiring company feels compelled to withdraw its bid in the face of “overwhelming opposition” that would be costly to overcome.
2. The part of the deal involving the target state or a third-party state involved in the transaction has, for all intents and purposes, been vetoed through either a forced divestiture of the facilities/subsidiaries in its country or through some other similar means.
3. A lengthy review process is undertaken, from which the company does not believe its bid will emerge successfully, either because
  - a. The review process has extended in time to a point where it is proving too costly for the company to proceed,<sup>34</sup> or because
  - b. The government has indicated to the company that it is unlikely to emerge from the process successfully.

Anonymous sources confirm that in the US, for example, CFIUS and/or its member organizations will indicate to a company whether or not it is likely to emerge successfully from a CFIUS review or investigation. This is one of the reasons why the number of withdrawals during the review/investigation process is exponentially higher than the number of vetoes.<sup>35</sup> It is possible that an effective block might not initially succeed in stopping the parties involved in a transaction from trying to conclude a particular deal. However, a state can still *formally* veto a deal if an effective block fails. If the companies involved fail to notify the relevant national authorities before a transaction is completed, many countries also maintain the right to review the takeover after completion, and to unwind it (in whole or in part) if it is deemed to pose a threat to national security.

“Unbounded” opposition is usually motivated by geopolitical concerns, and involves companies that state *A* is concerned with protecting on national security grounds. In the US, these will often be the most highly politicized cases, as interest groups may be able to prey more effectively on post-9/11 sensitivities to national security. It is important to note again, however, that while interest groups might raise the alarm about a deal, they will rarely affect its outcome. It is also possible that some of these cases will simultaneously raise *competition* concerns in other government agencies – agencies that might seek to veto the deal on those grounds instead. It is therefore important to control for such alternative explanations of intervention as the hypothesis is being tested.

### **Bounded Interventions**

Bounded interventions are considered to be those that result in deals that the government has been able to alter in its favor through some means or another. Though the effect of interest groups and competition concerns will be controlled for, it is usually expected that “bounded” balancing will most often be motivated either purely by the national security concerns raised by the geopolitical competition context of the case and/or by economic nationalism surrounding companies in the sectors associated by the state with national security. It is also expected that in the latter case, states may closely identify “national security” with “economic security.”

In the US, for instance, mitigation may take a couple of different broad forms. Graham and Marchick, for example, note that “if the DOD believes that the risks [to national security] it identifies can be managed, it may also negotiate mitigation measures with the transaction party,” which “generally fall into four categories (in ascending order of restrictiveness)” (Graham & Marchick 2006, 71). These are “board

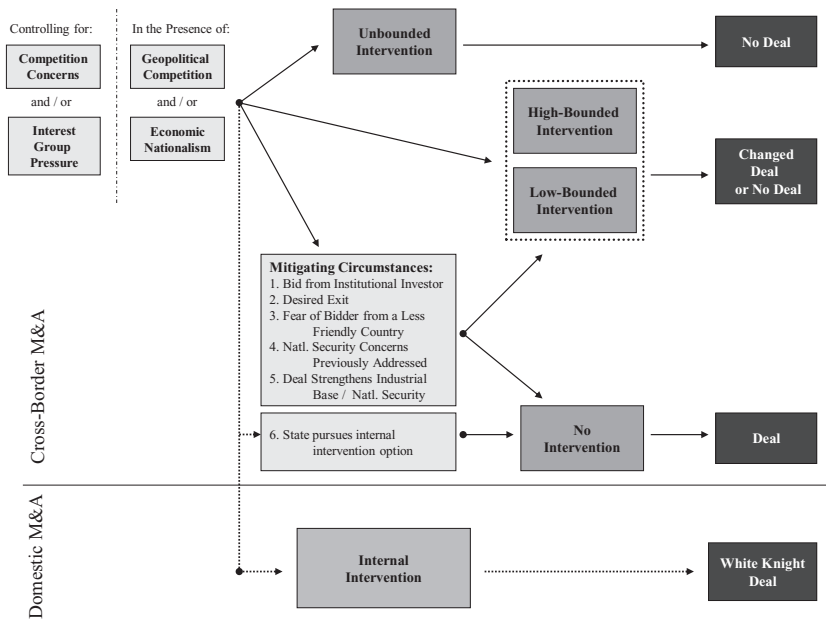
resolution,” “limited facility clearance,” a “Special Security Agreement (SSA)”<sup>36</sup> or “Security Control Agreement (SCA),”<sup>37</sup> and a “voting trust agreement” or a “proxy trust agreement”<sup>38</sup> (Graham & Marchick 2006, 71–2).

One recent CFIUS decision, concerning the Alcatel/Lucent deal (examined in Chapter 5), also made it clear that *new* forms of mitigation may be emerging. In the review of that takeover, the US included an “evergreen” clause as part of the security agreement between itself and the companies involved, which basically means that the US government retains the right to force a reversal of the deal at any point in the future if it discovers that Alcatel has not lived up to its promises regarding measures to safeguard US national security.<sup>39</sup> Members of the legal community have indicated their belief that such a clause has never been used before in a US security agreement regarding a cross-border acquisition (Interview 2007). It should also be noted that forced divestitures, while not common in the US, do occur there and in other countries as a form of mitigation. (For further discussion of the different types of mitigation used in the US and abroad, see Chapter 5).

Though there are many different forms that mitigation may take, and these forms vary by country, the US forms of mitigation will be used as the standard, as they are the most highly institutionalized and the most is known about them. Similar phenomena will be looked for in the other countries in order to determine whether or not a deal has been altered. That being said, the actual existence of most of these forms of mitigation in an individual case is meant to be confidential, and their content is usually classified. Thus, we will only know of the existence of these forms of mitigation if they have been made public through a press release issued by one of the companies in question, or if news of their existence has been leaked to the press or other open-source intelligence outlets. This will obviously skew any statistical results away from the correlation that this study seeks to find between mitigation and the variables proposed here. This is an acceptable reality, however, as it means that we can largely assume that any correlation found is likely to be much stronger than the statistical results indicate.

One of the reasons why we are more likely to see bounded intervention among the allies of the Western security communities (meaning the transatlantic partnership and the EU) is because the process for the review of cross-border M&A is more highly institutionalized among the Western advanced industrial states. Indeed, it is most highly institutionalized in the US, which is why the US is where we should expect to see the lowest level of interest group influence on outcomes of the review process. The process is less institutionalized within Europe, but

**Figure 5 Non-military internal balancing through M&A intervention**



*Note: This diagram illustrates the intervention options a state might pursue when it believes a specified cross-border M&A transaction could pose a risk to national security.*

still much more advanced than it is in, say, Russia or China, where there is very little transparency about the review process. Higher levels of institutionalization allow allies to find alternative solutions to national security concerns, beyond simply prohibiting a deal or evidencing such overwhelming opposition that the proposed acquirer voluntarily withdraws from the process. Beyond the more closed natures of their markets and the risks they pose for investors, such differences in institutionalization may also contribute to the extremely low levels of cross-border deals in Russia and China for the sectors discussed in this book.

**Non-Intervention**

The following circumstances allow a proposed deal, that would normally be mitigated, to go through without any visible intervention (Figure 5). (Again, it must be noted that some of those deals that seem to go through without intervention may have actually been mitigated in some way by the host state of the target company, but, due to the classified nature of that mitigation, it may not be possible to tell.)

First, if the bid for the target company comes from an institutional investor<sup>40</sup> based in a foreign country, or a consortium of institutional investors from multiple countries, intervention may be less likely. Here, it is expected that the deal will be more likely to go through, because institutional investors are generally viewed as more focused on profit than politics, and are also viewed as being largely independent from government control or influence. Exceptions may occur: for example, when governments fear that an institutional investor will run the company into the ground, or sell the company in question to an unfriendly country.

Second, there may be a reduced probability of intervention if the deal in question involves a company that the government wishes to be sold, i.e., the sale is a “desired exit,” and there is a realization that it cannot be sold domestically. In this case, the cross-border deal is less likely to face intervention if the sale can be made to a handpicked friendly country.

Third, a deal that may have initially faced strenuous opposition from the government may suddenly be welcomed if another, less-desirable company is rumored to be making, or actually announces, a bid for the target company. In other words, imagine that state *A* initially opposes a bid for company *X* by a company *Z* from state *B* (which is neither a true ally, nor an enemy). Then, a company *Y*, influenced or controlled directly by state *C* (with whom state *A* is on a less friendly footing), is known to be contemplating a bid for *X*. The fear of the bidder from state *C* may very well cause state *A* to withdraw its opposition to the initial bid by state *B* (see, e.g., the Arcelor/Mittal deal in Chapter 6).

Fourth, a deal may face little or no opposition if the national security concerns that would normally be raised have been previously addressed in some way. An example of this in the US would be if the company in question had already negotiated a special security agreement for the type of deal at hand, and the government did not feel that it needed to negotiate a new one. (As discussed in Chapter 6, BAE Systems serves as an excellent example of a company that has benefited from already having a comprehensive security agreement with the US government.)

Fifth, a deal may face little or no intervention if it is considered to be advantageous to the defense industrial base in some way, or is perceived to be advantageous to national security.<sup>41</sup> The deal might, for example, increase the competition among companies in the production of a good vital to national security (such as semiconductors), or provide the state in question with access to a resource that it desperately needs.

Finally, (un)bounded intervention into a particular proposed foreign takeover may prove unnecessary if the option of internal intervention is



pursued, obviating the need for such direct intervention. This concept is explained in the following section, and again more fully in Chapter 6.

### Internal Intervention

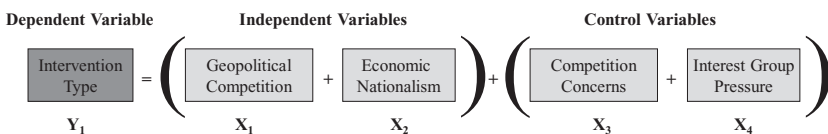
Internal intervention is an alternative for governments seeking to protect a specific company from a foreign takeover. It usually occurs when a company considered by the government to be vital to national security (and possibly to be a national champion) is deemed to be a vulnerable takeover target by the market. Rather than waiting for a bid that may potentially come from an unfriendly source, the government in question *proactively* seeks a domestic alternative. This may mean that the government actively encourages another domestic company to take over (or merge with) the vulnerable company, or that it encourages domestic investors, companies, or government-backed entities to purchase a large stake in the company in order to promote a high level of cross-shareholding that makes a foreign takeover more difficult.

### Methodology

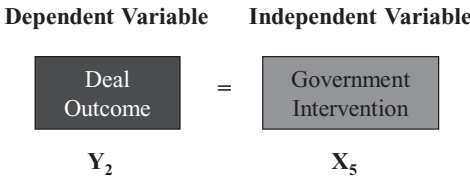
Three hypotheses emerge from this theory. The primary hypothesis tested here is that government use of domestic barriers to foreign takeovers of companies on national security grounds depends on (1) the geostrategic implications/concerns raised by the potential takeover and (2) the level of economic nationalism in the target company's home state, controlling for (3) the economic competition concerns raised by the potential takeover and (4) the presence of interest groups with access to power in the home state of the target company that oppose the foreign acquisition of that company (Figure 6).

The second hypothesis follows from this, namely: that the outcome of a proposed cross-border merger or acquisition will be strongly affected by the type of intervention employed by state *A* (Figure 7). In other words, it is expected that unbounded interventions will typically lead to a "no deal" outcome, i.e., where the proposed takeover is blocked or thwarted. Bounded intervention will be expected to result in a deal that

**Figure 6 Hypothesis #1**



**Figure 7 Hypothesis #2**

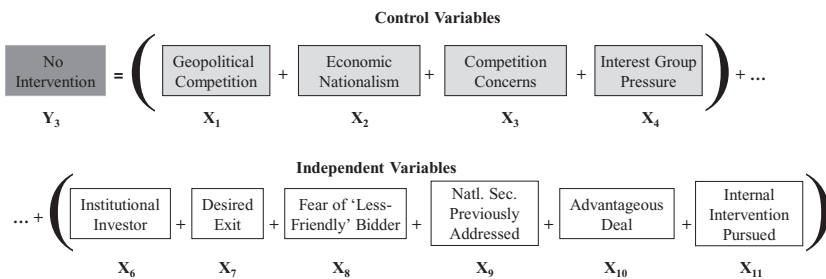


is changed or altered to the target state’s advantage, and occasionally to lead to a “no deal” outcome. No intervention on the part of the target state’s government, on the other hand, will typically mean that a deal will be more likely to go through unmitigated.

The third is a supporting hypothesis. Controlling for the presence of economic nationalism, geopolitical competition between states *A* and *B*, competition concerns, and interest group pressure, it is argued that a foreign takeover will be least likely to face visible intervention by state *A* when any of the following conditions are met: the presence of an institutional investor, the ability to achieve a desired exit, fear of a less-friendly bidder, the national security concerns have been previously addressed, the deal is advantageous for another reason, or internal intervention is pursued (Figure 8). While resource and space constraints prevent a full statistical testing of this hypothesis, it will be examined qualitatively in Chapter 6 (which discusses those cases where governments do not intervene in foreign takeovers), and may prove fertile ground as an avenue for future research.

The first and second hypotheses *will* be rigorously tested, both quantitatively and qualitatively. They will be looked at qualitatively through an examination of ten critical cases and three illustrative supporting cases across all four categories of: (1) *unbounded* intervention, (2) *bounded*

**Figure 8 Hypothesis #3**



**Figure 9 Critical cases**

Critical Cases					
	Acquiror	Country	Target	Country	Industry
Unbounded	CNOOC Ltd.	China <sup>†</sup>	Unocal Corporation	USA	Oil
	Dubai Ports World	UAE	P&O Co.	UK	Infrastructure
	PepsiCo Inc.	USA	Groupe Danone	France	Other
	Check Point Software Technologies Ltd.	Israel	Sourcefire Inc.	USA	High-Tech
	Macquarie Bank Ltd.	Australia	PCCW Ltd.	China	Telecom
Bounded	Alcatel SA	France	Lucent Technologies Inc.	USA	Telecom
	Lenovo Group Ltd.	China	IBM Corporation's PC Business	USA	High-Tech
	Finmeccanica* (Defense electronics div.)	Italy	BAE Systems plc	UK	Defense
	BAE Systems plc*	UK	United Defense Technologies	USA	Defense
None	Compagnie Générale de Géophysique (CGG)	France	Veritas DGC	USA	Oil & Gas (Seismic Data)
	JP Morgan	USA	Troika Dialog	Russia	Investment Banking
Internal	Gaz de France SA	France	Suez SA	France	Electricity/ Gas/Water
	Rusal*	Russia	Sual Group	Russia	Aluminum

<sup>†</sup> *The company is listed in Hong Kong.*

\* *Abbreviated case included for illustrative purposes.*

intervention, (3) *no* intervention, and (4) *internal* intervention. These cases are listed in Figure 9.

The data will also be examined quantitatively through the use of categorical data analysis (CDA). Toward this end, a database was created of every cross-border M&A transaction in a set of sectors that states commonly associate with *national security* (Figure 10), which occurred in the six years following 9/11. There are a few reasons for adopting these parameters. First, the start date of the database was chosen because the security environment changed on September 11, 2001 in a manner sufficient to cause some states to be concerned with sectors of the economy that had previously not been identified with national security. The US, for example, now includes the “critical infrastructure” of the nation among such sectors. As the US is subject to the most foreign takeovers of any one country on a yearly basis (UNCTAD 2016b), it is important to limit the time frame in such a way that the cases can be considered comparable. The database ends in 2007, just before the beginning of the Great Recession, which had an immediate, negative, and severe impact on cross-border mergers and acquisitions activity globally.<sup>42</sup> The time period of the database thus offers a relatively stable

**Figure 10 Commonly identified national security sectors (listed by ICB code)**

<b>Sector</b>	<b>Benchmark</b>	<b>Industries</b>
Oil & Gas	0533, 0537 0573, 0577	Oil & Gas Producers Oil Equipment, Services & Distribution
Basic Resources (Industrial Metals)	1753 1757	Aluminum Steel
Industrials	2713 2717 2773	Aerospace Defense Marine Transportation
Telecommunications	6535 6537 6575	Fixed Line Telecommunications Mobile Telecommunications Satellite Telecommunications
Utilities	7535 7573 7575 7577	Electricity Gas Distribution Multi-utilities Water
Financials	8777	Investment Services (Stock Exchanges)
Technology	9537* 9572 9576 9578	Software Computer Hardware Semiconductors Telecommunications Equipment

\* Included only when the target company is known to retain a defense-related contract at the time of the transaction.

Note: Sector, benchmark, and industry titles sourced from [www.icbenchmark.com](http://www.icbenchmark.com).

economic and security environment in which to test our hypotheses, though both of these environmental factors vary sufficiently during this period for the purposes of quantitative analysis.

Second, it is maintained here that the sectors listed in Figure 10 are those that are most often identified by nations with national security in the post-9/11 environment. As most states prefer to maintain a flexible approach to the scope of security, few choose to actually define or delineate those sectors they associate with national security, as already discussed. The economic sectors identified with national security have thus changed over time (Graham & Marchick 2006).<sup>43</sup> This list, therefore, does not attempt to be exhaustive, but seeks to represent those basic industries that both anonymous and written sources most commonly identify as posing security concerns vis-à-vis foreign takeovers today (see e.g., Graham & Marchick 2006; UNCTAD 2016b; Wehrlé

& Pohl 2016). Some sectors have been purposely left out because of the lack of identifiable (versus actual) intervention activity in recent years, making it difficult to accurately assess levels of government interference. Figure 10 identifies each sector used in this study according to its “Industry Classification Benchmark” (ICB; a coding system used to track M&A transactions).<sup>44</sup> Given the thousands of cross-border M&A transactions that took place globally during this time period, it was important for practical reasons to narrow the statistical inquiry down to those sectors where we are most likely to see intervention. The only case that arose in the course of my research that falls outside of these sectors for the time period of this database, the PepsiCo/Danone case, has been included in the critical case studies. The dynamics and findings should not change, however, if the hypotheses were to be tested against all sectors of the economy.

The cases are limited in scope to mid- to large-cap deals where the enterprise value of the target company is estimated to be over \$500 million. This is largely because small-cap deals often do not receive the type of global press, analyst, sector, and database coverage necessary to ensure accurate coding of all of the variables involved in the creation of the database. Coverage for mid- to large-cap deals, however, is extremely good, allowing for comprehensive and accurate coding of these transactions.

Cases are also limited to those in which companies in the US, China, Russia, or one of the first fifteen members of the EU were the targets. This set of countries has been chosen for a number of reasons. First, and most importantly, they offer a wide range of approaches to government intervention in foreign takeovers. Second, they offer variance in that some of the first set are “advanced industrialized” societies, while China and Russia may be considered to be advanced *industrializing* powers. The inclusion of the latter is important to demonstrate that these hypotheses do not only hold for the most advanced Western industrial nations. At the same time, it does not make sense to include lesser developed nations among the cases examined here, because the developing world is subject to a separate set of dynamics within the process of globalization and interdependence that would make those cases less comparable. The advanced Western industrial states of Australia and Canada were not included in the dataset because their respective “national interest” and “net benefit” tests for FDI can make it difficult to disentangle when these states intervene on the grounds of national security from when they do so for more traditional economic protectionist reasons (e.g., to save jobs), making cases involving these countries less comparable.

Third, both the US and the EU belong to strong security communities, from within which foreign takeover bids are likely to originate. Furthermore, this activity flows in two directions within those security communities. US companies will take over EU companies, and vice versa, in the transatlantic security community. Within the community of the EU itself, foreign takeovers also occur without unidirectional flow. Russia and China provide an excellent contrast to this. Even though Russia may arguably maintain a series of strong alliances that resembles a security community, the nations within that community rarely engage in takeovers of Russian companies, but Russian companies will often seek acquisitions within its allied nations as well as without. The same is largely true for China.

Finally, it is important to include non-US states in the database because the theory of non-military internal balancing presented in this work is neither US-centric nor necessarily dependent on a unipolar environment. Cases involving the US do figure prominently in this study, as the US remains a hegemonic power, is the recipient of more cross-border M&A than any other country alone, accounts for roughly one-fifth of the value of cross-border M&A globally as a recipient target country (though this of course varies by year),<sup>45</sup> and has a highly institutionalized and sophisticated approach to addressing national security risks in the context of FDI. Yet, because the theory presented in this work is *not* US-centric or dependent upon a specific power context (uni-, bi-, or multipolar), it is also very important to examine not just those cases in which the US is being balanced *against*, but also those where the US might be balancing another state, or where balancing might be occurring against other states entirely, such as China, Russia, or France. In all, eighteen target countries are thus examined in the dataset, and five are covered in the critical case studies. Again, it would be an excellent area of further study to include a greater number of countries in the dataset, but this would have exponentially increased the number of cases studied beyond the point of feasibility for this work, without necessarily improving the picture or understanding sought herein.

For the purposes of this investigation, the parameter of cases was also narrowed to those examples of the purest form of cross-border M&A in order to allow for the clearest possible investigation of the relationship between the host state of the target company (state *A*) and the host state of the acquiring company (state *B*). In other words, cross-border cases were limited to those that took one of the forms represented in Figure 11.<sup>46</sup> In all, 209 cases were determined to fit these criteria, out of the 1,238 M&As that fit the other parameters of the database outlined earlier.

**Figure 11 Cross-border case types<sup>47</sup>**

State of Parent Company of Acquirer	State of Acquiring Company	State of Target Company	State of Vendor Company
(State B) State B	State B State A	State A State A	(State A) (State A)

*Note: Certain values of the vendor and parent companies have been placed in parentheses to signify the fact that they may or may not necessarily be present in a given transaction.*

### Conclusion

The purpose of this book is to explain why states intervene in the foreign takeovers of companies on national security grounds, even within security communities founded on economic liberalism and integration. If the argument proposed in this chapter is accurate, the case studies and statistical findings should support the hypotheses presented here. For example, the cases are expected to support the conclusion that geostrategic concerns and economic nationalism are the best explanation for the use of such domestic barriers to foreign takeovers. I also expect to find that where geostrategic issues are the most important factor in determining whether or not domestic barriers are used, these barriers equate to a more intense form of non-military internal balancing of economic power, and the proposed takeover in question will usually be blocked. In this case, I expect to see that the home state of the target company perceives a large potential loss of relative power to the home state of the acquiring company should the bid go through, and that the relative cost of non-military internal balancing in this form is not perceived to be disruptive to the greater relationship between the two countries. I also expect to find that most of the cases that occur within the security community context, where geostrategic concerns are low, can be explained by the high presence of economic nationalism. Lastly, it is anticipated that the variables controlling for the alternative explanations (namely for concerns over competition and interest group presence) will be low in those cases where such domestic barriers are used. For example, one would anticipate a number of cases where those domestic interest groups that should be the most influential – i.e., economists, the market, and shareholders – are over-ruled or ignored by their own governments: governments who instead cast their actions in terms of national security. Such findings would support the idea that the primary hypothesis stated here

may provide a more satisfactory explanation of the puzzle than could an interest group or other domestic politics explanation.

The phenomenon being studied here is of great significance, for a number of reasons. As discussed in the Introduction, the theory of non-military internal balancing presented in this book has implications for international relations theory, policymakers, and business alike. First and foremost, it provides an important addition to our understanding of power and how it is balanced in the international system – especially within the context of increased inter-state competition within the economic sphere. Second, explaining why states use intervention into foreign takeovers as a means of non-military internal balancing in the most unlikely of cases, i.e., within common security and liberal economic communities, will help deepen our understanding of the theoretical relationship between economic interdependence and levels of conflict within the international system. Third, if states repeatedly *overbalance* or miscalculate in their use of this particular tool of statecraft, there could be a potential impact on globalization.

Fourth, there are implications for international law, as efforts to create a multilateral treaty on foreign investment and foreign takeovers are continually thwarted by disagreement over how to handle sovereign intervention in key national security industries. Understanding when and why governments engage in such intervention would shed much light on this international legal process. Fifth, it is vital to understand the relationship between national security and the ownership of key industrial, technology, and energy companies, given state concern over resource competition and dependence on foreign oil. Sixth, the creation of domestic barriers by states to foreign takeovers is increasingly a matter of great concern for traders, investors, and economists, as well as for those states whose economies are affected by these actions. Lastly, in the process of trying to solve a previously unexplained empirical puzzle, it is hoped that this book will contribute to the literature on the political economy of international security.

## NOTES

- 1 For a further discussion of these approaches, and a breakdown of how some states use multiple approaches, see Wehrlé & Pohl 2016, 10–16, and particularly Table 1 therein.
- 2 Like the second approach, states may use this type of review system to look at cross-border M&A in either a specific set of sectors or across the whole economy (Wehrlé & Pohl 2016, 11–16).
- 3 States do, however, agree that in relation to FDI, “essential security concerns are self-judging” (OECD 2009, 3).



- 4 For the full text, see the *Defense Production Act of 1950*, US Code 50, App. 2061 et seq.
- 5 These institutions include CFIUS, Section 721 of the 1950 DPA, and other associated foreign merger, acquisition, and takeover review processes in the US, as discussed in Chapter 3.
- 6 Graham and Marchick (2006) provide one of the most detailed investigations into the dynamics between national security and FDI through M&A in the US, and offer invaluable insights into this process.
- 7 Graham and Marchick note that concerns over espionage date back to the US' experience with Germany during World War I, when it was discovered that the Germans sought to control US companies (particularly in the vital chemicals sector) in order to gain technological, economic, and military advantages over the US (Graham & Marchick 2006, 2–18). They explain how “public and official attention to German investment intensified following a 1915 incident in which a German diplomat accidentally left a briefcase on New York’s elevated transit. Materials found in the briefcase indicated that some German-controlled operations in the US were aimed at, or at least useful for, *enhancing German war capabilities, reducing Allied capabilities, or spying on the United States*” (Graham & Marchick 2006, 4, emphasis added). Significantly, this brought it home to US legislators “that at least some German investment in the US was meant to achieve sinister ends, even for cases in which the apparent purpose of the investment was purely for commercial gain” (Graham & Marchick 2006, 4).
- 8 Graham and Marchick claim that public concern over this issue, plus comprehensive confirmatory evidence provided to the government by the CIA and FBI, has affected the way Chinese takeovers are handled by CFIUS (Graham & Marchick 2006, 113).
- 9 As discussed in Chapter 3, *formal* vetoes are just one way in which a government can block a foreign takeover. Thus, the rarity of formal vetoes should not lull the reader into a belief that other forms of intervention taken to block a takeover are not a more common and frequent occurrence across the globe – for they are.
- 10 MAMCO did not hold classified government contracts, but was a contractor to Boeing, and held “some” technology “subject to US export controls” (Bush 1990). It was believed that the takeover was an effort by the Chinese government to obviate these control requirements and gain entrance into the industry in order to later pursue predatory practices (Interview 2006). CFIUS thus found “credible evidence that . . . the foreign interest exercising control [China] might take action that threatens to impair the national security” as a result of the deal, and President George H. W. Bush formally announced that the deal was prohibited on February 2, 1990 (Bush 1990).
- 11 In January 2006, Russia suspended natural gas supplies to the Ukraine in order to obtain that state’s acceptance of higher gas prices (Nichol et al. 2006). Russia threatened to do so again in 2007, and then cut off supplies once more in January 2009 as the result of another price dispute. These disputes with the Ukraine often affected European supply more generally,

an issue the opening of the Nord Stream pipeline in 2011 (which bypasses the Ukraine) was meant to alleviate (Buckley & Gorst 2011). Price disputes continue, however, and during the cold snap of 2012, Gazprom diverted supplies away from Europe and to domestic customers, arguing that it was the EU's "politically motivated" policies to liberalize gas markets [that] had set the stage for the supply disruptions" (Gorst 2012). The Russian government also played a large role in Gazprom's takeover of its foreign partners' (Royal Dutch Shell of Great Britain and Mitsui and Mitsubishi of Japan) stake in the Sakhalin-2 gas project (Radio Free Europe 2006). In "an attempt to improve Gazprom's bargaining position," Russia "threatened [the project with] . . . administrative sanctions, withdrawal of key permits, and environmental damages" (Radio Free Europe 2006), causing some to believe that "a 'soft nationalization' is taking place in [such] sectors of Russia's economy" (Gutierrez 2006). Rumors even surfaced in 2006 that a confidential NATO report argued that Russia's intent was to create an oligopoly in the natural gas industry. It is not surprising, then, that governments are sensitive to cross-border acquisitions that threaten to diminish their control over important resources.

- 12 US openness in this regard is a factor not just of the volume of inward FDI in that country, and of the desire to increase understanding of the CFIUS process at home and abroad, but also of the level of global scrutiny the US (and CFIUS) has faced in comparison to other countries, largely as a result of its prominence in the FDI market and on the global stage.
- 13 Governments are not required to specify the national security concern or risk they believe to be associated with a specified transaction, as to do so might itself compromise national security.
- 14 Keohane and Nye define *dependence* as "a state of being determined or significantly affected by external forces" and *interdependence* as "mutual dependence," meaning "situations characterized by reciprocal effects among countries" (Keohane & Nye 1989, 8).
- 15 Hirschman speaks of a somewhat similar phenomena, namely that there is an "influence effect of foreign trade," where he notes that "even if war could be eliminated, foreign trade would lead to relationships of dependence and influence between nations" (Hirschman 1945, 15). Waltz also discusses sensitivity and vulnerability interdependence (Waltz 1979, 139–46).
- 16 In observing the nefarious and predatory behavior of the Nazi regime in its trading relationship with Southeastern and Central Europe, Hirschman illustrates that a state *A* might purposefully use an initial advantage in an interdependent trading relationship to enhance its economic power position relative to another state *B*. This might be done by following economic policies that (1) enhance the position of state *A* as a supplier to state *B* of critical "goods needed for the war machine" and (2) make it harder for state *B* to try to disengage from that relationship (Hirschman 1945, 34–5). This illustrates the possibility that states (whether or not they are as yet engaged in military conflict) might pursue policies of economic warfare by either "depriving the enemy of [the] imports" on which they have become dependent, or placing an "export embargo" on those resources (Ripsman 2005, 19–20).

- 17 For example, Waltz argues that the possession of nuclear weapons by most major economic players in the game of advanced economic interdependence will reduce their focus on relative military power and increase their focus on the relative “distribution of gains” from international trade (Waltz 1993, 74). Similarly, Keohane and Nye point out the value of economic influence in an environment where “in many contemporary situations, the use of force is so costly, and its threat so difficult to make credible, that a military strategy is an act of desperation” (Keohane & Nye 1989, 18).
- 18 Here, power is defined as both capabilities and the *potential* of state *A* to have influence over state *B*.
- 19 Shambaugh provides a detailed discussion of the role of dominance and dependence in the power relations of states in interdependent relationships (Shambaugh 1999, 10–18).
- 20 For a good discussion of Lakatos and progress in international relations theory, see Elman & Elman (2003).
- 21 For parsimony, Waltz also assumes that states are “unitary” actors (Waltz 1979, 93–7).
- 22 Walt (1987) argues that states balance not just power, but also *threat*.
- 23 The acts usually associated with external and internal balancing (i.e., “alliance making and military buildups”) can only truly be considered to be balancing when “taken for the purpose of checking and blocking ambitions or [they] have that consequence” (Vasquez & Elman 2003, 91).
- 24 For such treatments of internal balancing, see e.g., Layne in Paul et al. 2004, 105; Mearsheimer 2001, 157; Vasquez in Vasquez & Elman 2003, 91.
- 25 Regarding internal balancing, Brawley believes that the military component is an “arms race” and the economic component involves “strengthen[ing] oneself through economic development” or engaging in investment strategies focused on bolstering your economy (in Paul et al. 2004, 82, 85).
- 26 For good examples of the soft balancing literature, see e.g., Pape 2005; Paul 2005; Walt 2005.
- 27 As with certain conceptualizations of soft balancing, the nature of the non-military internal balancing technique means that it is fairly “low cost” and “not likely to invite intense retribution” (Paul in Paul et al. 2004, 4).
- 28 As with soft balancing, or Brawley’s understanding of economic internal balancing, the time frame may be longer and the urgency to balance through military means lower or (at that moment) non-existent. In other words, it may be that “at the moment, the rising state may not be a challenge” for the intervening state, “but in the future, without counterbalancing, it may emerge as a key source of insecurity for the states concerned” (Paul in Paul et al. 2004, 14).
- 29 Whether or not the distinction between high and low politics is “misplaced” (Waltz 1993, 63), such intervention is not usually considered by the general populace to be a form of balancing. Even the most politicized of cases are not seen as belonging to the realm of “high politics.”
- 30 If the state is not involved in the company, it is not a matter for state comment. In order to show offense, it would have to deny the right of states to veto foreign takeovers on national security grounds, and then forego that

- right itself. Alternatively, if state *B* is directly involved in the company pursuing the acquisition, then state *A*'s concerns will appear largely valid to the international community (even if the states involved are on the friendliest of terms). For, there would appear to have been some effort by state *B* to gain backdoor access to technology or resources in state *A*, over which state *A* did not desire to relinquish control.
- 31 For clarity, the host state of a target company is designated as “state *A*,” the host state of the acquiring company as “state *B*” (or the sending state), the target company as “company *X*,” and the acquiring company as “company *Z*.”
  - 32 An anonymous source has pointed out that once the US government is made aware of the security implications of a takeover it might have otherwise overlooked, the government then makes it quite clear to the interest groups involved that it will not be pressured into a decision in either direction. Interest groups are reminded of the institutionalized procedures for takeover reviews under US law, and that this process remains above their influence.
  - 33 To reduce government action in any case to just the Head of State or Executive would be to ignore the complexity of the foreign policymaking process, and (in the US especially) would ignore the checks-and-balances systems that are part of this process for some governments. In each country, I examine the actions of the government as a whole, rather than just focusing on the Executive. In France, for example, I look at the actions of the Prime Minister, as well as the President, regulatory bodies, and parliament; for UK transactions, I examine the regulatory bodies as well as the Prime Minister, parliament, and royalty; and so forth. Though the Executive may take the final decision in many review processes, and often retains the right to make this decision regardless of the recommendations of the rest of its government, it would be wrong to assume that the opinion of the rest of the government is not, at times, taken into consideration. Moreover, in the US case, Congress can pass laws to try to “effectively” veto a transaction by lengthening the review process, or by denying funds for the review process, thereby participating in that process whether the Executive likes it or not (this may occur in other democracies as well). This is a good example of why it is important to study government response as a whole.
  - 34 If the proposed bid were going to be financed through debt rather than (or in addition to) cash or stock, then the debt that had already been raised could be costly to maintain until the bidding process is over. There are also audience and opportunity costs associated with a lengthy bidding process, which the acquiring company may wish to avoid if they become too onerous.
  - 35 There have only been four presidential vetoes of a transaction since 1988 (see Bush 1990; Obama 2012, 2016; US DOT 2008, 2009, 2013, 2017). Yet, from the beginning of CY 1988 to the end of CY 2007, there were 1,841 notifications of transactions voluntarily made to CFIUS, of which thirty-seven went to the “full investigation” stage and forty-seven were withdrawn from the process by potential acquirers, either during the initial review stage, before they could be taken to investigation, or during the investigation

- phase, before the findings of the Committee could be sent to the President. After the passage of FINSA, the number and percentage of voluntary withdrawals increased, so that out of 782 total notifications made to CFIUS from 2008 to 2014, thirty-eight bids were withdrawn during the *pre*-investigation review, and a further forty-nine were withdrawn during the full investigation phase (author's calculations from US Department of Treasury data, compiled from: Graham & Marchick 2006, 57; US DOT 2008, 2013, 2016a). Yet, as Wallace and Armon (2005) point out, such numbers still "fail to capture CFIUS's real influence," as the threat of review and rejection often prevents companies from pursuing takeovers in the first place. This is important, because every deal that is visibly rejected by a country on national security grounds may indicate hundreds of others that were never even pursued due to potential opposition.
- 36 A special security agreement is an agreement that may be made between the US government and the foreign acquirer of a US company when that company has sensitive/classified facilities, programs, and/or contracts with the US government. It obliges the foreign acquirer to adhere to "all the requirements of any cleared firm in the NISP [National Industrial Security Program]" and would mean, for example, that while the "prerogatives of ownership [would be] retained by [the] foreign investor," the company's "decisions [would have to be] monitored by US Outside Directors," who would be required to have a certain level of security clearance with the US government (DSS 2008). For further information on special security agreements and the NISP, see the Defense Security Service's (DSS) website on industrial security: [www.dss.mil/isp/index.html](http://www.dss.mil/isp/index.html).
- 37 According to the DSS, a security control agreement can be used in those situations "when the cleared company is not effectively owned or controlled by a foreign entity and the foreign interest is entitled to representation on the company's governing board" (DSS 2016a).
- 38 According to DSS, both proxy agreements (PAs) and voting trust agreements (VTAs) can "be used when a cleared company is effectively owned or controlled by a foreign entity" (DSS 2016a). Both PAs and VTAs "are substantially identical arrangements whereby the voting rights of the foreign owned stock are vested in cleared US citizens approved by the Federal Government" (DSS 2016a). According to Reynolds (2004), a "foreign-influenced parent company will have limited authority over the company subject to the Proxy Agreement or Voting Trust and will be restricted even in its access to business information about the company." For further information on PAs, VTAs, SSAs, SCAs, and Board Resolutions, see DSS 2016a.
- 39 For a good discussion of this issue, see Smith 2006.
- 40 This term can have multiple definitions; the one used here is discussed further in Chapter 6.
- 41 For an excellent test of how this might be determined, see Moran 1993.
- 42 The database includes the population of deals (within the parameters discussed here) that were concluded (positively or negatively) between 9/11/2001 and 5/15/2007 (when initial access to some of the data sources ended, and coding began). More importantly, however, this time period was

- later retained because cross-border M&A activity slowed significantly and steadily as a result of the onset of the financial crisis soon thereafter, and has not yet shown significant recovery, providing an excellent period of relative stability for comparison. In comparison to CY 2007, for example, the total global value of cross-border M&A deals was down 40% in CY 2008, 72% in CY 2009, and 75% in CY 2013, and remained down by 30% in 2015 (UNCTAD 2016b).
- 43 As Graham and Marchick (2006) point out, the chemical and telecommunications industries were originally deemed among the most important to protect; since then, additional industries have become of concern to many states, including those related to “critical infrastructure.” Tyson (1992) pointed out the importance of high-tech and electronics (especially the semiconductor) industries in the 1990’s, and these remain vital to national security today (Graham & Marchick 2006). Additionally, the aerospace and defense and the oil and energy industries have been identified by the US as vital to national security over several decades, and these sectors (and others) are identified as vital to national security in Europe, too. Some states maintain classified lists of strategic sectors barred from public ownership (see OECD 2006a). This range of sectors varies across time and nations, making it important to explain the choice behind the sectors of the economy identified with national security in this study.
- 44 Sector, benchmark, and industry titles were sourced from [www.icbenchmark.com](http://www.icbenchmark.com).
- 45 The US accounts for the following percentage values of cross-border M&A (reported by CY for the economy of the seller/target): 31% in 2001, 22% in 2002 and 2003, 16% in 2004, 13% in 2005, 20% in 2006, 17% in 2007, 36% in 2008, 23% in 2009, 24% in 2010, 26% in 2011, 20% in 2012, 17% in 2013, 4% in 2014, and 41% in 2015 (author’s calculations from data provided in the Annex Tables of UNCTAD 2016b).
- 46 The Zephyr M&A database was used to help determine which cases fit most of these parameters. Zephyr is an online database of global financial deals that is used by both the academic and the private sectors for this type of research. Zephyr’s definition of a “cross-border” takeover was not used here, however, because it did not have the precision needed for this particular investigation. For example, Zephyr denotes cases as “cross-border” when a company headquartered in state *C* takes over the assets of a company in state *D* that are physically located in state *C*, and which had been previously owned by another company headquartered in state *C*. In such cases, it would be difficult to fully test the dynamics of the relationship between the host state of the target company and that of the acquiring company. Zephyr also precludes cases from the cross-border classification in which a company from state *Z* uses a newly created shell acquisition company registered in state *X* to take over a company in state *X* – even though such an act is a clear example of a foreign takeover for the purposes of this book. The author, therefore, began with all 1,238 M&A transactions that fit the other parameters of the database, and then narrowed them down to 209 cases of “simple,” or “pure,” cross-border M&A cases as defined earlier. It should also be noted that the

Zephyr database does not currently use the ICB system. However, one can reach the same number of initial cases as the author (1,238) by starting a search within Zephyr using similar sectors from any of the other classification systems, and then paring down the number of cases by recoding the target companies according to their ICB numbers.

- 47 A “vendor” refers to the entity selling the target, which is usually (but not always) its parent company. A “parent” company is that which owns the majority stake in a given company.