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US and Japanese National Security Regulation on Foreign Direct Investment

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Rikako Watai, Japan Studies Visiting Fellow at the East-West Center in Washington, explains that "The critical issue is how to balance the legitimate demands of national security with free trade and FDI, but citing opaque national security concerns for justifying protectionist measures clearly obstructs the GATT-WTO premise of free trade."

Foreign Direct Investment and National Security

The United States and Japan are the first and third largest economies in the world respectively, and major recipients of inward foreign direct investment (FDI). However, FDI from competitor states can raise national security concerns, as was the case in the United States concerning FDI from Japan during the 1980s through to the 1990s. Economic security, akin to national security, is prioritized by countries throughout the world as is evidenced by the Security Exceptions of the 1948 General Agreement on Tariffs and Trade (GATT) that preceded today's World Trade Organization (WTO) charter. However, national security has never been defined either in the United States or in Japan. The only legal reference found on this subject is from US Supreme Court Justice Hugo Black, who in his 1971 concurring opinion on the Pentagon Papers, wrote that national security is a "broad, vague generality." Any attempt to adopt regulations on FDI based on national security is coupled with ambiguity and interpretations that vary both in the United States and Japan.

The US Approach

The call for new regulations in the United States concerning FDI began to gain momentum in 1987 when Fujitsu, a Japanese computer company, tried to acquire Fairchild, an American semiconductor company. Fujitsu withdrew the acquisition plan when it faced severe objections from the Reagan administration. This culminated in the enactment of the Exon-Florio Amendment (Exon-Florio) in 1988. Exon-Florio empowered the president to stop foreign takeovers if they were perceived to pose a threat to national security. The new law did not contain a clear definition of national security and due restraint was exercised. In only one case was an acquisition blocked, when in 1990 the China Aero-Technology Import & Export Corporation (CATIC) tried to purchase the aircraft parts manufacturer MAMCO. However, in a number of other instances, foreign governments and companies voluntarily renounced their plans before been officially blocked, as in the case of Fujitsu-Fairchild.

Exon-Florio was amended in 2007 during President George W. Bush's administration to the new Foreign Investment and National Security Act (FINSA). This was, in part, a response to the failed attempts by the Chinese company CNOOC to acquire the US oil company Unocal in 2005, and Dubai Ports World to manage six US ports in 2006. Both attracted attention because of national security concerns.

President Barack Obama, citing national security concerns, used his power under FINSA in September 2012 when he blocked the Chinese-owned US company, Ralls Corporation, from acquiring wind farm projects located close to a US Navy training facility in Oregon. This was the first time since the blocking of CATIC in 1990 that a

president exercised his power to stop a foreign acquisition. Ralls subsequently filed a lawsuit in US Federal Court but most of the claims were dismissed because FINSA has a provision that actions by the president shall not be subject to judicial review. Since this decision, US government officials have made it clear that there have been no policy changes regarding FDI coming into the United States.

Furthermore, the Ralls case has highlighted problems within FINSA, specifically regarding due process. The president clearly has broad discretion in exercising his power under FINSA, but any presidential decision has to be open to accountability, explanation and transparency—the fundamental elements of the rule of law. The on-going Ralls case continues to attract attention from foreign investors and its outcome could influence future FDI into the United States, as will the outcome of the bid by the Chinese company Shuanghui International to purchase Virginia-based Smithfield Foods.

"Regulation of FDI will always be a policy challenge, and in order to realize the full potential of market globalization countries will have to be more transparent in communicating to foreign investors when national security concerns will prevail over free trade."

The Japanese Approach

Beginning in the 1990s, foreign-affiliated companies began entering the Japanese economy in growing numbers. While this is a good move for the economy as a whole, it raises a number of questions related to national security. Japan's approach initially was to regulate FDI based on the 1949 Foreign Exchange and Foreign Trade Act (FEFTA). While this law contained provisions for controlling FDI, Japanese authorities preferred to utilize a mechanism known as "administrative guidance." This informal practice came under criticism from foreign investors for creating a regulatory regime that lacked legal grounds. In response to these criticisms, rules under FEFTA were revised in 2007—the same year as FINSA —for the purpose of promoting international investment while also ensuring national security, and were patterned on the Exon-Florio review mechanism that created FINSA.

The new regulations introduced a list of designated industries important to Japan, and foreign investors are required to give the government prior notice of their plans to purchase one of those designated industries. In such cases, when a foreign acquisition is deemed to be problematic from the perspective of national security, the first course of action is for the Minister of Finance, or the minister with jurisdiction over the industry in question, to issue a recommendation to the parties calling for a specific change or suspension. If the parties fail to abide by the recommendation, an order is then issued to enforce the specific changes or suspend the transaction. Such an order was issued in 2008 citing national security concerns in a case involving a share purchase of Electric Power Development Co., Ltd. (J-Power) by the London-based Children's Investment Fund (TCI). Unlike FINSA, it was possible to challenge the order, but TCI decided not to bring the case to the Japanese courts.

Future Reforms Required

The critical issue is how to balance the legitimate demands of national security with free trade and FDI, but citing opaque national security concerns for justifying protectionist measures clearly obstructs the GATT-WTO premise of free trade.

Both the United States and Japan can do more to refine their regulations regarding FDI by making the process more accountable. In the case of the United States, producing a public list of industries that will be subject to strict scrutiny for FDI would be a good start, somewhat along the lines of what Japan has done. For its part, Japan has to acknowledge that foreign takeovers of Japanese companies that are not on the list of designated industries are completely exempt from giving prior notice to the government. Therefore, the list has to be precise and not ambiguous. Regulation of FDI will always be a policy challenge, and in order to realize the full potential of market globalization countries will have to be more transparent in communicating to foreign investors when national security concerns will prevail over free trade.

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