
National Security Review: Concepts, International Experiences and Implications for China

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National Security Review of foreign M&As in China

- Article 31 of China's Anti-Monopoly Law:

“In addition to concentration checks stipulated by this Law, foreign mergers with, or acquisitions of, domestic companies or participation of foreign capital in undertakings concentration in other forms, which may have a bearing on national security, shall go through national security checks according to relevant laws and regulations.”

China's AML: Concentrations of Undertakings (Ch. 4)

- Definition of concentrations (Art. 20 of AML):
 - Mergers;
 - Acquisitions (equities or assets); or
 - Acquisition by contracts or other means of control of other undertakings

- May include (MOFCOM, Sept. 2007, pp.174-176):
 - JVs/strategic alliances
 - Interlocking directorate
 - Patent licensing contract

Merger review under China's AML

- Factors to be considered in concentration review (Art. 27):
 1. Market shares and market power of merger parties in the relevant market;
 2. Degree of market concentration;
 3. Effects on market entry and technology progress;
 4. Effects on consumers and other related undertakings;
 5. Effects on the development of the national economy; and
 6. Other factors affecting competition as determined by the Anti-Monopoly Authority under the State Council.

National security debate in China

- The concept of national security (or economic security) did not receive much attention in China until around 2002.
- *Catalogue for the Guidance of Foreign Investment 2002*
 - FDI that harms national security shall be prohibited (Art. 7)
- The *Interim Provisions on the Mergers with and Acquisition of Domestic Enterprises by Foreign Investors* (2003, MOFCOM)

Interim Provisions on the Mergers with and Acquisition of Domestic Enterprises by Foreign Investors (2003, MOFCOM)

- Article 1 of the Provisions provides that “the rules are formulated in order to “promote and regulate foreign investors’ investment in China and introduction of advanced technology and management experiences from abroad, improve the utilization of foreign investment, rationalize allocation of resources, ensure employment, and safeguard fair competition and the **national economic security**.”

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- *2006 Provisions on Mergers with and Acquisitions of Domestic Enterprises by Foreign Investors.*
 - Apply to business transactions that lead to de facto control of domestic enterprises.
 - Require that transactions that lead to control of “well-known and or traditional trademarks or brand names in China” be reported to the MOFCOM for review.
 - Third, “economic security” is once again a main factor in reviewing foreign acquisition of domestic enterprises under the 2006 new merger regulations.

National Security Review in the AML (Article 31)

- Article 31 of the AML
NS review under relevant laws and regulations
- But exactly how NS review works, or even what it means, in China is not clear.
- Awaiting detailed guidelines

Increasing fear of foreign acquisitions of domestic firms

- Alleged “Killing off domestic brand names” via joint ventures or M&As (since late 1990s-)
 - Households products
 - Cosmetic industries
 - Bottled water
 - Dairy products
- Unsuccessful acquisition of XuGong, China’s leading construction machinery maker, by Carlyle Group (2005-08)
- Concerns over the proposed acquisition of Huiyuan Juice by Coca Cola (2008)

National security debate in China

- 2006 report of the Chinese Academy of Social Sciences

China's Economic Security under Opening to the Outside World

- Many talk and are worried about the threat of FDI to **industry security**
 - Foreign acquisitions of leading domestic firms
 - Loss of “Chinese brand names”
 - Loss of state owned assets
- Some view setting up a national security review system as a retaliatory weapon toward foreign governments’ NS review of Chinese firms’ overseas acquisitions.
 - (in particular the failed acquisition of Unocal by the CNOOC in 2005).

The meaning of NS in China

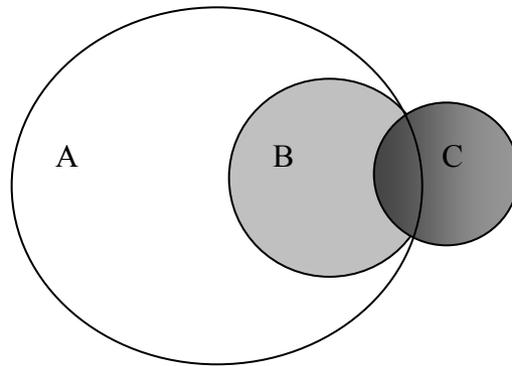
- What does national security refer to in China?
 - Many people talk about **industrial security**
 - Many use the term **economic security**

 - According to MOFCOM (2007), national security “generally speaking includes **military security, economic security, and political security**. It requires that **key industries** of the economy be controlled and operated by domestic firms and that involvement and control by foreign government or firms be prevented (p. 266)”.

The meaning of NS:

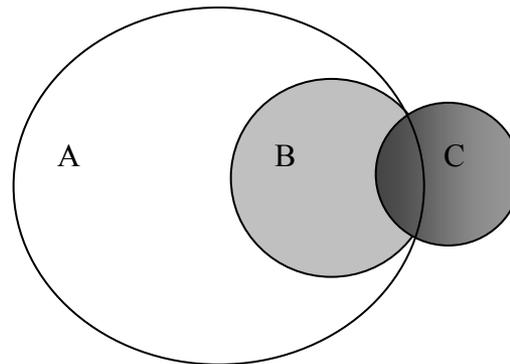
A diagrammatical presentation

- A – set of M&As threatening industrial security
- B – set of M&As threatening economic security (security of key industries)
- C – set of M&As threatening national defense



The meaning of NS: (cont'd)

- Coca Cola – Huiyuan is in A (probably) but not B (i.e., in $A - B$).
- Lenovo-IBM acquisition would be in C but not B (i.e. in $C - B$).
- CNOOC-Unocal would be (probably) in both B and C.



International experiences: the US

- The Exon-Florio Amendment (1988)
- CFIUS review: mostly set C (i.e., national defense), at least in the earlier years
 - Domestic production needed for projected national defense requirement;
 - The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies or services;
 - the control of domestic industries and commercial activity by foreign citizens as it affects IS capability and capacity to meeting national security requirements;
 - The potential effects of the transaction on the sales of military goods and, equipment, or technology to a country that supports terrorism or proliferates missile technology or chemical or biological weapons; and
 - The potential effects of the transaction on US technological leadership in areas affecting US national security.

International experiences: US (cont'd)

- Attempt to include the effects on “essential commerce” and “economic welfare” (set B in the chart?) in the initial Exon-Florio bill was rejected.
- So the US basically looks at set C.
- Presence of foreign government ownership is viewed as of greater NS risks, and leads to greater scrutiny.
- 25 investigations from 1988-2005 (out of 1593 notifications); some caveat.
- More strict criteria after 2007 amendment.

International experiences: UK

- Under the Enterprise Act 2002, the Secretary of State may intervene in any merger he considers raises concerns relevant to a public interest consideration.

- 2 + 1 public interest considerations specified:
 - national security
 - plurality, quality and standards in the media; and
 - stability of the financial system

- 7 public interest cases so far (2002-2008):
 - 5 in the defense sector,
 - 1 in media; and
 - 1 in banking.

- So UK reviews C + a very small B.

International experiences/development (cont'd)

- France:
 - Military + key industries (C + a large B)
- Russia (in progress)
 - Emphasis on energy and resources sector (C + a large B)
- India (in progress)
 - Military + “sensitive sectors or areas” (C + a small B)

China's plan?

- NDRC's proposal (2007) for economic security review:
 - 9 key sectors + 9 key areas
 - National defense
 - Electricity generation and distribution
 - Oil
 - Coal
 - Telecommunications
 - Airlines
 - Shipping
 - Financial market
 - Culture/media

China: NDRC's proposal 2007: 9 key sectors + 9 key areas (cont'd)

- 9 key areas:
 - Major machinery/equipment manufacturing
 - Electronic and information industry
 - Automobile
 - Construction
 - Steel
 - Non-ferrous metals
 - Chemical
 - Resources exploration
 - Science and technology

Implications for China

- Military security (set C) is the minimum.
- Economic security contains “key sectors/areas” only.
- Industrial security should not be a part of NS review (unless in key industries):
 - A – B should not be a part of NS review.
- Would be useful to define “key sectors” (i.e. The boundary of set B)
 - The NDRC proposed 9 + 9 list seems too long
 - Construction, automobile, steel, etc. are crucial for economic growth; not clear they are crucial for economic security.

Implications for China (cont'd)

- Criteria for NS review is security, not competitiveness or dominant market position of domestic firms.
- NS review should not become a tool for industrial policy (set B cannot be too large)
 - That is, NS review should not be used to protect the market position of domestic firms, under the name of protecting industrial security.
- Anti-Monopoly, National security, and industrial policy are all important, but
 - They are different and even have conflicting policy goals.
 - They should not be tools for one another.

- Thank you -

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