

National Security Legislation and National Innovation Systems: An International Trend Towards Investment Controls

Thomas Malta-Kira

Abstract: This article discusses recent global trends in implementing economic controls framed around national security concerns, focusing specifically on investment controls. It discusses how legislation should be carefully drafted taking into consideration the specific context of individual national innovation systems and how similar approaches to this legislation from other jurisdictions might not be strategically applicable in the context of newly industrialized nations.

Keywords: national security; investment controls; innovation systems; economic policy; technology.

Legislação sobre segurança nacional e sistemas nacionais de inovação: uma tendência internacional para controles de investimentos

Resumo: Este artigo discute as recentes tendências globais na implementação de controles econômicos formulados em torno das preocupações com a segurança nacional, focando especificamente nos controles de investimento. Discute como a legislação deve ser redigida com cuidado, considerando o contexto específico dos sistemas nacionais de inovação individuais e como abordagens a essa legislação feitas de modo semelhante ao de outras jurisdições podem não ser estrategicamente aplicáveis no contexto de nações recém-industrializadas.

Palavras-chave: segurança nacional; controles de investimento; sistemas de inovação; política econômica; tecnologia.

In recent years, national security concerns have increasingly come to the fore in policy discussions around critical components of open innovation that affect National Innovation Systems (NIS). With an increasing awareness of great power competition and geopolitical friction, governments worldwide are grappling with balancing the need to protect national security with the desire to foster innovation and promote economic growth. These trade-offs face governments operating in the context of the growing significance of certain new technologies for security and defense.

This article assesses the need for a greater understanding of the trade-offs this balancing process involves, specifically in terms of the impact of such interventions on the operation of dynamic and complex systems that produce innovation. Some examples of such trade-offs are often more apparent to policymakers than others. For example, the concept that stringent security-driven policies that impact the labor market, such as strict visa controls, might have knock-on effects on people-to-people knowledge exchange and the movement of skilled human capital, potentially stifling innovation, or that stringent intellectual property regulations framed around the protection of industrial knowledge might inadvertently restrict legitimate technology diffusion and collaboration among actors within an innovation system. A greater ability to isolate, understand, and account for these trade-offs is essential for achieving effective policies in this space, allowing for a more nuanced and informed approach to policy formulation whilst not undermining the objectives of national security-driven policy itself.

Ultimately, it is assumed that these policies are formed to protect the interests of the State concerned and its population, and inadvertently undermining these interests in the technological innovation space to a degree that outweighs the gains of implementing a given national security control can ultimately be counterproductive to these interests in the long run.

This mix includes the more direct positive impact on security and defense that a well-functioning NIS can produce. A lack of consideration for the circular impact on national security that a given control might have through its effect on the innovation of spin-off or dual-use security or military technology, especially through

Thomas Malta-Kira is a consultant with expertise in technology, investment, and national security. He holds an MPhil from the University of Oxford, and is a PhD researcher at the University of Cambridge. He previously worked in an embassy, in corporate intelligence, as lecturer for Stanford University, and as tutor at Cambridge Judge Business School.

processes of civil-military integration (CMI), could again prove counterproductive in the long run. That is not to say that said controls should not be pursued, but that they must be formed in a manner sensitive to these long-term effects to properly maximize security outcomes. As economic security policies are being strengthened in the aforementioned broader geopolitical context, major advanced economies are securing supply chains, looking to prevent the transfer of advanced technologies, and putting protections on key infrastructure and data in place. Nevertheless, there is a concomitant desire to strengthen and support the research, development, and innovation of advanced technologies that promote national security and defense.

Within the broad category of national security-motivated legislation that impacts innovation systems, a notable trend towards developing or updating investment control legislation has emerged. Perhaps the most high-profile global development in this respect was the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), which strengthens and modernizes the operation of the Committee on Foreign Investment in the United States (CFIUS), a multi-agency government body chaired by the U.S. Secretary of the Treasury, and that reviews foreign investment for national security considerations. However, this phenomenon is by no means restricted to the United States, with numerous countries recently specifying and updating investment regulations that affect high-tech companies or those in “critical industries”. Recently, the United Kingdom, the European Union, and Japan, to name a few, have enacted and amended laws to regulate foreign investment. Some key examples include the UK’s National Security Investment Act (2021), the EU Regulation on the Screening of Foreign Direct Investment (2020), Japan’s revised Foreign Exchange and Foreign Trade Act (2020), and Korea’s Foreign Investment Security Review Procedure Operation Regulations (2022).

There is also a trend towards more stringent review of outbound investments as a “reverse CFIUS” is discussed in the United States. In August 2023, President Joe Biden signed the Executive Order Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, which authorizes the Secretary of the Treasury to regulate certain U.S. investments “into countries of concern in entities engaged in activities involving sensitive technologies critical to national security” in three sectors: semiconductors and microelectronics, quantum information technologies, and artificial intelligence. In an Annex to the EO, President Biden specifically identified the People’s Republic of China (PRC) as a country of concern (The White House 2023). The European Commission is also considering possible measures to address “security risks related to outbound investments” (European Commission 2023) and aims to propose such an initiative by the end of the year. The regulation of outbound investment would be distinct

from the commonplace measures categorized under export controls, which regulate the export of goods, software, and technology themselves, or measures to criminalize the transfer of “trade secrets” and industrial knowledge, as shown by the UK’s recent National Security Act (2023)¹.

This article moves from broadly addressing export, labor, and capital controls into focusing on investment controls as a subset of national security-motivated controls. It argues that although the impact of investment controls on markets and industrial systems is better understood, the impact of such controls on innovation systems requires more research. As noted above, a recent trend towards updating or renewing national security legislation will directly impact innovation systems. There needs to be more discussion in the literature on the dynamic impact of these legislative trends on the operation of the innovation systems discussed above and the civil-military processes within these systems. These dynamic interactions between this species of legislation and innovation systems must be understood so that the drafting and implementation of national security legislation can be well-informed and nuanced in its understanding of how to maximize the dual factors of innovation-led growth and national security and achieve a conscious balance that moves towards the best strategic outcome for a given state in the long run.

[A]lthough the impact of investment controls on markets and industrial systems is better understood, the impact of such controls on innovation systems requires more research.

MODES OF NATIONAL SECURITY-RELATED ECONOMIC CONTROLS AND AREAS OF INTERACTION

These considerations and analysis of these interactions can sit within a broader literature on the interaction between national security and innovation. However, this literature has been broadly concerned with industrial policy and with considerations including government support for research and development (R&D) through mechanisms such as forming public-private research networks or procurement.

Here, we focus on legislative controls, which attempt to regulate essential input-output flows in innovation systems. These regulations do not usually frame these controls in terms of innovation systems, or address their effects.

1. The UK’s National Security Act (2023) is distinct from the National Security Investment Act (2021).

National Innovation Systems can be defined as “the elements and relationships, which interact in the diffusion, production and use of new and economically useful knowledge (...) either located within or rooted inside the borders of a nation-state” (Lundvall 1992). This is a nationally defined view prevalent in early innovation systems literature and which is also apparent in the definition of National Innovation Systems as “the national institutions, their incentive structures and their competencies, that determine the rate and direction of technological learning (or the volume and composition of change generating activities) in a country” provided by Patel and Pavitt (1994).

In this section, I briefly outline the forms of national security-framed economic controls in legislation before focusing on investment controls in this context. We can broadly separate national security controls and legislation into three categories while assuming considerable overlap and interaction: export controls, labor controls, and capital controls.

Export Controls

National security concerns have led governments to implement export controls to safeguard critical technologies, sensitive information, and strategic resources from falling into unauthorized hands. The link between national security and export controls has become a significant aspect of contemporary international trade regulations. Governments worldwide have adopted export controls to protect their vital interests, technological advancements, and military capabilities. These controls prevent unauthorized transfers of sensitive goods, technologies, and know-how that could compromise national security. The primary objectives of export controls are to protect national security interests by preventing the unauthorized transfer of critical technologies, sensitive information, and strategic resources to unauthorized entities or hostile actors. Export controls seek to preserve military advantage, safeguard national defense capabilities, and prevent the proliferation of weapons of mass destruction (WMD) and other strategic assets. Additionally, export controls ensure compliance with international non-proliferation treaties and agreements.

Countries implement export controls through comprehensive legal frameworks designed to regulate the export of sensitive goods and technologies. These frameworks often include lists of controlled items, technology transfer restrictions, and licensing procedures. The United States, for instance, has export controls administered by agencies like the Bureau of Industry and Security (BIS) under the Export Administration Regulations (EAR) and the International Traffic in Arms Regulations (ITAR) overseen by the Directorate of Defense Trade Controls

(DDTC) (Matheny 2011). Another key example is Taiwan's Foreign Trade Act and Regulations Governing Export of Commodities, administered by its Bureau of Foreign Trade, which operates in an especially dynamic regional geopolitical context and housing a highly developed and globally competitive semiconductor industry. One significant challenge is balancing safeguarding national security interests and avoiding undue restrictions on legitimate trade and technology transfer. Overly restrictive controls may limit market access for businesses and hinder technological advancement. The rapidly evolving nature of technology and the global supply chain may also compromise the effectiveness of export controls. Determining which technologies are genuinely sensitive and controlling their transfer poses an ongoing challenge. Therefore, overly prescriptive methods could be counterproductive, and more agile regulatory structures (such as agency-led control list-type approaches) might be advantageous here. However, constant ministerial oversight, if concentrated, can also lead to a degree of arbitrariness and undermine predictability. The implications of export controls on global trade and international relations are significant. Export controls can disrupt supply chains, affecting exporters and importers of controlled goods and technologies. They may increase business costs and potential retaliatory measures from other countries.

One significant challenge is balancing safeguarding national security interests and avoiding undue restrictions on legitimate trade and technology transfer. Overly restrictive controls may limit market access for businesses and hinder technological advancement. The rapidly evolving nature of technology and the global supply chain may also compromise the effectiveness of export controls. Determining which technologies are genuinely sensitive and controlling their transfer poses an ongoing challenge.

A subset worth noting is the criminalization of the transfer of knowledge and “trade secrets” in the sense of industrial espionage, and a trend towards such legislation is also prevalent, coupled with controls on the export of information understood as beneficial to the interests of a foreign power and against the interests

of the host State. Such legislation is clearly interlinked with the concept of export controls as it impacts tangibles and non-tangibles. It should be considered alongside export controls in the context of a knowledge-driven economy and innovation system openness. In this regard, a very recent piece of legislation is the UK's National Security Bill (2023), which has just received royal assent at the time of this article's writing.

Labor Controls

Labor controls can be used to serve diverse national security objectives. One of the primary goals is to protect domestic employment by regulating the influx of foreign labor in sensitive sectors. These frameworks encompass visa and work permit regulations, labor market testing requirements, and restrictions on foreign labor participation in specific industries. An example of restricting participation is the restriction of public sector positions to citizens or even natural-born citizens. In the United Kingdom, the Civil Service Nationality Rules currently allow applications from European Economic Area (EEA) nationals (including British citizens), Commonwealth citizens, and Swiss and Turkish nationals. However, only UK nationals are eligible for employment in reserved posts. People applying to join the UK's armed forces must be British or Commonwealth citizens or from the Republic of Ireland (either as a sole or dual national). A starker example in the subset of visa and work permit regulations that have had broader ramifications is the recent U.S.-China "Visa War," where the U.S. revoked visas for Chinese scholars over security concerns.

Countries with high-security concerns may have strict visa requirements and quotas for foreign workers in critical industries. In contrast, others may have more flexible labor mobility policies to attract skilled labor and boost economic growth. Labor controls may hinder workforce mobility, reducing opportunities for international cooperation and knowledge exchange, and stricter labor controls can lead to labor shortages in critical industries, impacting productivity and growth. Such controls may limit innovation by restricting access to diverse talent and expertise.

Capital Controls

The convergence of national security with capital controls has become a crucial aspect of contemporary economic policymaking. Governments worldwide have utilized capital controls to address national security concerns associated with financial stability, economic vulnerability, and technological dependency. One

established objective is safeguarding financial stability by mitigating the risks of speculative capital flows, currency volatility, and potential systemic crises. By limiting the sudden outflows of capital during economic stress, countries seek to maintain a stable and resilient financial system.

However, a key motivation for capital controls is to protect strategic industries from foreign acquisitions and undue foreign influence. Governments may use capital controls to prevent hostile takeovers of critical assets and maintain control over strategic sectors that have national security implications. Moreover, capital controls address technological dependency and protect national interests related to intellectual property rights, data privacy, and sensitive technologies. Controlling the flow of capital can help prevent the unauthorized transfer of critical technologies to foreign entities.

[A] key motivation for capital controls is to protect strategic industries from foreign acquisitions and undue foreign influence. Governments may use capital controls to prevent hostile takeovers of critical assets and maintain control over strategic sectors that have national security implications.

Implementing capital controls involves comprehensive legal frameworks tailored to address specific national security priorities. These frameworks may include regulations on cross-border capital flows, foreign direct investment (FDI) restrictions, and financial transaction monitoring. Various countries have adopted specific legal mechanisms to implement capital controls based on their unique economic and security considerations. For example, Iceland utilized capital controls during its 2008 financial crisis to prevent a sudden outflow of foreign investments, protecting its financial system (Baldursson & Thorlaksson 2023). Similarly, China has implemented capital controls to manage capital flows and maintain monetary stability, especially during economic uncertainty.

The implementation of capital controls for national security purposes faces several challenges. One significant challenge is balancing safeguarding national security interests and maintaining an attractive investment climate. Stricter capital controls may deter foreign investors and limit access to capital, potentially impacting economic growth and innovation. Capital controls may increase regulatory burdens and compliance costs for businesses, particularly cross-border transactions, reducing international investment and trade and limiting a country's economic opportunities and global competitiveness. Stricter capital controls can

reduce foreign direct investment, portfolio flows, and cross-border transactions, limiting a country's access to foreign capital and impeding economic growth.

Overly restrictive capital controls can be vulnerable to evasion and may foster informal or illicit financial activities. Capital flight through informal channels can thereby undermine the effectiveness of official controls and hinder the achievement of national security objectives. Therefore, the implications of capital controls on international capital flows and economic growth can be significant and well understood when implementing such policies, especially in a given specific national context. Capital controls play a critical role in protecting national security interests by regulating international capital flow. However, their implementation requires careful consideration of potential challenges and implications for international capital flows and economic growth. Striking a balance between safeguarding national security imperatives and fostering an attractive investment climate is essential.

INVESTMENT CONTROLS

National security and investment controls have become increasingly intertwined in international trade and foreign investments. Governments worldwide are utilizing regulatory frameworks to safeguard national security interests while striking a balance to maintain open markets and attract foreign investment. There is a need for robust, transparent, and predictable investment control mechanisms.

The interplay between national security and foreign investments has brought investment controls to the forefront of global policy discussions. As nations seek to protect their critical assets and technologies from foreign influence, investment controls have emerged as a critical instrument to safeguard national security interests. These controls regulate cross-border investments, mergers, and acquisitions that have implications for national security.

The primary objective of investment controls is to protect critical assets, industries, and technologies that have strategic importance to a country's national security. Such controls prevent foreign acquisitions or investments that may lead to unauthorized access to sensitive information, intellectual property theft, or undue influence over key sectors. By carefully scrutinizing inbound investments, countries aim to mitigate potential risks while ensuring that foreign direct investments do not compromise their core national interests.

Investment controls are implemented through legal frameworks, which vary from country to country. Some nations have specific laws and regulations solely dedicated to foreign investment review processes for national security purposes,

while others incorporate investment controls within broader national security legislation. Countries like the United States, Australia, and Canada have well-established mechanisms to review and assess foreign investments for potential national security risks, such as the Committee on Foreign Investment in the United States (CFIUS) and the Investment Canada Act. The European Union recently introduced the Foreign Direct Investment Screening Regulation to coordinate investment screening among its member States.

Implementing investment controls for national security has faced several challenges and criticisms. One key challenge is striking a balance between safeguarding national security and maintaining an attractive investment climate. Stricter investment controls may deter foreign investors and limit access to capital, potentially impacting economic growth and innovation.

Additionally, investment controls can be vulnerable to political manipulation and protectionist motives, leading to accusations of discriminatory practices or lack of transparency. Critics argue that ambiguous criteria and discretionary decision-making in investment reviews may undermine confidence in the regulatory process and deter legitimate foreign investors.

The growing use of investment controls for national security purposes has significant implications for businesses and the global economy. Businesses need to navigate complex regulatory landscapes, engaging in risk assessments and due diligence to understand their investments' potential national security implications. Heightened scrutiny may lead to longer approval processes and increased compliance costs for investors, affecting the speed and ease of cross-border transactions. For the global economy, an increasing trend toward investment controls could hinder international trade and investment flows, potentially fragmenting markets and reducing overall economic growth.

Investment controls have become critical for nations seeking to protect their national security interests in an interconnected global economy. While the objectives of investment controls are justified, their implementation requires careful consideration to strike the right balance between national security and fostering an environment conducive to foreign investment and innovation. Transparent, predictable, and non-discriminatory investment control mechanisms can safeguard national security while promoting international trade and economic prosperity.

The choice to focus on investment controls as a form of capital controls is driven by recent global developments that have highlighted their significance in addressing national security concerns and protecting critical assets and industries. Investment controls have emerged as crucial mechanisms for governments to safeguard their

economic sovereignty, technological advancements, and strategic interests in an increasingly interconnected and competitive global economy. Several examples of legislation and policy developments worldwide illustrate the growing prominence of investment controls as an essential tool in national security and economic policymaking.

The United States has significantly strengthened its investment control regime in recent years. The enactment of the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018 expanded the Committee on Foreign Investment in the United States (CFIUS) scope. CFIUS now has broader jurisdiction to review and scrutinize foreign acquisitions of critical infrastructure, sensitive technologies, and emerging technologies that may pose national security risks. The legislation empowers CFIUS to block or impose conditions on foreign investments deemed to threaten national security interests. This key legislation was coupled with the Export Control Reform Act of 2018 (ECRA), which forms its counterpart in the export control category outlined above.

The U.S. has an established history of investment controls. Early investment controls included legislation such as the Trading with the Enemy Act (1917) which gave powers to control investments in enemy countries and assets owned by enemy nationals. Through amendment by the 1933 Emergency Banking Act, powers were extended. In World War II, the First War Powers Act of 1941 gave the U.S. President greater authority to regulate foreign investment and control critical assets deemed vital to the nation's defense. Following World War II, the Cold War era brought new security challenges but also meant that investment controls, amongst other controls, were reframed to address more strategically framed interests, as opposed to previous legislation, primarily framed around active belligerents in wartime scenarios.

The choice to focus on investment controls as a form of capital controls is driven by recent global developments that have highlighted their significance in addressing national security concerns and protecting critical assets and industries. Investment controls have emerged as crucial mechanisms for governments to safeguard their economic sovereignty, technological advancements, and strategic interests in an increasingly interconnected and competitive global economy.

The passage of the Defense Production Act of 1950 granted the President authority to impose controls on certain foreign investments that might threaten national security. This more comprehensive approach framed around broad national security concerns led to the establishment of the CFIUS in 1975, which, following the Exon-Florio Amendment in 1988, was given a strengthened authority to review foreign acquisitions of U.S. companies, expanding CFIUS's jurisdiction, allowing it to review transactions that could result in "foreign control", broadly defined, of a U.S. business, even if the transaction did not involve a controlling interest through majority. As noted above, the passage of FIRRMA significantly expands CFIUS's authority and scope to review certain non-controlling investments, real estate transactions, and critical technologies related to national security. It also provides CFIUS with additional resources to address the evolving landscape of national security concerns. FIRRMA marks, therefore, another step-change in investment control.

As with the case of the United States, early development in modern investment controls in the UK happened in the early 20th century, when during World War I, the UK enacted the Trading with the Enemy Act (1914), and World War II saw the Trading with the Enemy Act 1939 receive royal assent. As with the case of the United States, this early legislation targeted hostile nations during wartime. However, it began to develop into peacetime-focused regulation in the mid-20th century.

In the UK contemporary context, the key piece of legislation enacted in the recent trend was the National Security Investment Act (2021), which, coupled with the recent National Security Act (2023), forms the UK equivalent legislation to the aforementioned U.S. developments. The bill, which became the National Security and Investment Act 2021, was announced in the Queen's Speech in December 2019, and the Act received royal assent in April 2021, coming into force in January 2022.

Until the National Security Investment Act 2021 (NSIA), the UK had used the Enterprise Act 2002 as the legislative basis to examine mergers for national security purposes. Following a review, the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018 (S.I. 2018/578) and the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2018 (S.I. 2018/593) provided short-term measures leading up to the introduction of NSIA. It amended the "share of supply" and "turnover" thresholds to allow the Secretary of State to intervene in more mergers on public interest grounds in three sectors of military or dual-use goods subject to export control, computer processing units, and quantum technology.

A further two orders, the Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2020 (S.I. 2020/748) and the Enterprise Act 2002 (Turnover Test) (Amendment) Order 2020 (S.I. 2020/763) were made on July 20, 2020 to

expand on the 2018 measures. These orders expanded the “share of supply” and “turnover” thresholds to enable the Secretary of State to intervene in mergers on public interest grounds in three additional sectors of the economy where the amended share of supply and turnover thresholds were artificial intelligence (AI), cryptographic authentication technologies, and advanced materials.

The NSIA established a comprehensive regime including powers, amongst others, to issue “call-in” notices that the Secretary of State may use to call in acquisitions of control over qualifying entities or assets (“trigger events”) to undertake a national security assessment whether or not they have been notified to the Government, a mandatory notification system requiring proposed acquirers of certain shares or voting rights in specified qualifying entities to obtain clearance from the Secretary of State for their acquisitions before they take place, enable the Secretary of State to amend by regulations the acquisitions which fall within scope of the mandatory notification system, a voluntary notification system which encourages notifications from parties who consider that their trigger event may raise national security concerns.

The NSI Act thereby significantly expands the Government’s powers to scrutinize and intervene in certain types of foreign investments that may have national security implications. Under the new legislation, the UK government has the authority to review and potentially block or impose conditions on foreign investments in 17 critical sectors, including defense, artificial intelligence, nuclear technology, and advanced materials. The NSI Act introduces a mandatory notification regime for investors in specified sectors, requiring them to notify the Government about transactions that may pose national security risks, allowing the Government to proactively assess and intervene in deals that may have significant security implications. It is worth noting the power to “call in” unnotified transactions and review them for potential national security concerns even after the completion of the transaction.

The NSI Act strengthened the legal framework for investment controls in the UK. It introduced a new Investment Security Unit responsible for reviewing investment notifications and conducting national security assessments. The then Business Energy and Industrial Strategy Select Committee² established a Sub-Committee on National Security and Investment to pursue an oversight function of this Unit. A reference was made to the model in the United States, where Congress provides formal oversight of the screening regime led by the CFIUS, with the chair of the Committee undertaking a short study visit to Washington DC to understand how congressional oversight of CFIUS operated.

2. In April 2023, following changes to the departmental structure of the UK Government, the Business, Energy and Industrial Strategy Committee was renamed the Business and Trade Committee to scrutinize the work of the department with the same name.

It has been hoped that this external scrutiny will give business stakeholders confidence in independent oversight, increased transparency, and accountability. This oversight remains with the business committee, and it should continue to provide it despite the Investment Security Unit moving under Cabinet Office control (Business and Trade Committee 2023).

The EU has also moved towards coordinated investment controls across member States to safeguard strategic industries and technologies. Regulation 2019/452 (as amended, the FDI Regulation or Foreign Direct Investment Screening Regulation) was adopted in March 2019 and has been applied since October 2020. The regulation establishes a framework for screening foreign investments that may affect security and public order across the EU. It encourages member States to exchange information and coordinate investment reviews to address shared security risks effectively. It is an important step in the European context, as it is the first to give the European Commission general powers to review private transactions since the entry into force of the EU Merger Regulation. This legislation differs from other examples we have noted in that it does not constitute an EU FDI screening mechanism but establishes minimum requirements for member States in their national FDI screening mechanisms and a mechanism for coordinating FDI reviews between member States. It is the clear desire of the Commission for member States to implement FDI screening mechanisms under this framework, and there has been a proliferation of FDI screening mechanisms across the EU as a result.

NATIONAL SECURITY-RELATED INVESTMENT CONTROLS IN BRAZIL

It is acknowledged that national security-related investment controls have emerged as a critical component of economic governance, and this criticality extends to Brazil, where the protection of strategic assets and technological advancements is paramount. The origins of national security-related investment controls in Brazil can be traced back to the mid-20th century. The establishment of strategic sectors and industries, such as defense, energy, and telecommunications, prompted the Brazilian Government to devise mechanisms to safeguard against undue foreign influence and potential threats to national security. This era witnessed the promulgation of laws and regulations to control foreign investment in sensitive areas.

The subsequent decades witnessed a series of policy shifts and legislative reforms that further refined Brazil's approach to national security-related investment controls. The 1990s ushered in a period of economic liberalization, prompting Brazil to reassess its investment control mechanisms in light of evolving global economic trends. The onset of globalization and increasing cross-border investment

flows necessitated a recalibration of Brazil's investment control framework. The 21st century witnessed a growing recognition of the need to balance economic openness and national security imperatives. Brazil's integration into global value chains and the expansion of foreign direct investment prompted policymakers to adopt a more nuanced approach to investment controls, accounting for economic opportunities and security concerns.

In recent years, Brazil has tried to modernize and institutionalize its investment control regime. The creation of dedicated agencies reflects the Government's commitment to streamline the review process and enhance transparency. These measures signify Brazil's recognition of the evolving nature of national security threats and the necessity of adapting its regulatory framework to address contemporary challenges.

Regarding broader economic controls, constitutional amendment EC 6/1995 removed distinctions between foreign and local capital, ending favorable treatment such as preference for winning bids and tax incentives for companies solely using local capital. Some elements of Brazil's constitutional law control foreign investment in critical sectors, including telecommunications (Law 12485/2011); aerospace (Law 7565/1986 a, Decree 6834/2009, updated by Law 12970/2014, Law 13133/2015, and Law 13319/2016); and maritime (Law 9432/1997, Decree 2256/1997).

In terms of a national security-framed investment screening process, Brazil has explored an updated framework but has yet to implement a strict national security-focused investment screening process in the mode of our previous discussion and in the context of a trend toward these controls globally. There is an existing requirement, however, for foreign investments to register with the Banco Central (Central Bank) within 30 days after investment, and investments that entail technology transfer or royalties must register with the Brazilian National Institute of Industrial Patent (INPI). However, it remains the case that Brazil currently needs a comprehensive investment screening mechanism that is framed around national security interests or born out of national security legislation.

In 2020, Bill No. 2491/2020 was presented to the Chamber of Deputies to regulate the inflow of foreign capital in Brazil to prevent operations that pose a risk to security or public order. The proposal aims to criminalize the use of foreign government-sponsored capital to gain control over economic activities, production chains, natural resources, technology, or companies within Brazil.

Concerning capital controls, the proposal introduces additional regulations for purchasing and selling foreign currency within the country. Per the bill, transactions exceeding US\$ 3 thousand would require completing a specific form and identity

checks. Presently, the exemption from this form requirement applies to transactions up to US\$ 10 thousand. Regarding foreign ownership, the bill also requires that company registrations provide comprehensive information regarding foreign capital ownership and its corresponding percentage.

In the realm of competition policy, the bill recommends revisions to the Brazilian Competition Law (Law No. 12529/11) to classify any transaction involving foreign capital as an offense against the economic order if it poses a risk to security or public order. Moreover, the bill proposes prohibiting mergers and acquisitions involving a significant presence of foreign capital and “substantial risks.” Transactions would present “substantial risks” when they involve mergers and acquisitions within infrastructure sectors such as energy, transportation, healthcare, and sanitation and within supply sectors such as energy and raw materials. Such transactions would be subject to assessment by the Administrative Council for Economic Defense (CADE), the Brazilian competition authority.

It is worth noting that Bill No. 2491/2020 did not gain approval in the previous legislative session. Consequently, it was reintroduced with the commencement of the new legislative session in 2023 and is currently under examination by the Chamber of Deputies’ Committee for Economic Development.

In terms of the global trend towards strengthening regulations, national security-related investment control models in developed countries may present the challenges we have discussed that may hinder their direct applicability in newly industrialized countries. There are nuanced considerations that need addressing

National security-related investment controls have become a crucial policy tool for developed countries to safeguard strategic assets and national interests. (...) [However, t]he economic landscape of newly industrialized countries is distinct from that of developed nations. (...) While developed countries may prioritize security over economic gains, Brazil’s reliance on foreign investment for growth compels policymakers to tailor investment control mechanisms to mitigate risks without deterring much-needed capital inflows.

when tailoring investment control mechanisms to suit the unique context of emerging economies. The limitations of transplanting developed-country models to countries undergoing industrialization might affect the feasibility of such measures in Brazil.

National security-related investment controls have become a crucial policy tool for developed countries to safeguard strategic assets and national interests. However, directly transplanting these models to newly industrialized countries, such as Brazil, presents complex challenges. Investment control models that have proven effective in developed nations may not seamlessly translate to Brazil's context.

The economic landscape of newly industrialized countries is distinct from that of developed nations. Brazil's economic growth trajectory, characterized by rapid industrialization and a growing need for foreign investment, necessitates a delicate balance between national security concerns and economic development imperatives. While developed countries may prioritize security over economic gains, Brazil's reliance on foreign investment for growth compels policymakers to tailor investment control mechanisms to mitigate risks without deterring much-needed capital inflows. The aforementioned effects of investment on the civil-military industry will also likely have a greater value in Brazil, where the military capabilities developed from an open National Innovation System will have a positive effect given Brazil's strong industrial capacity and history in these industries. ■

References

- Baldursson, Fridrik Mar, Richard Portes & Eirikur Elis Thorlaksson. 2023. "Capital Controls as a Bargaining Device: The Case of Iceland". *Review of International Economics* 31 (4): 1303-1328. <https://doi.org/10.1111/roie.12668>.
- Biden Jr., Joseph R.. 2023. "Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern". *The White House Briefing Room*. <https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/>.
- European Commission. 2023. *Joint Communication to the European Parliament, the European Council and the Council on 'European Economic Security Strategy'*. <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX%3A52023JC0020>.
- House of Commons - Business, Energy and Industrial Strategy Committee. 2023. "Memorandum of Understanding on Scrutiny of the Investment Security Unit". *Committee Report* (8). <https://publications.parliament.uk/pa/cm5803/cmselect/cmbeis/1235/report.html>.
- Lundvall, Bengt-Åke. 1992. "User-producer Relationships, National Systems of Innovation and Internationalization". *National Systems of Innovation: Toward a Theory of Innovation and Interactive Learning*: 45–67. <http://www.jstor.org/stable/j.ctt1gxp7cs.8>.
- Matheny III, Richard L. 2011. "So Many Feathers on the Scale: Whether and How to Voluntarily Disclose Violations of U.S. Export Controls and Economic Sanctions Laws". *Global Trade and Customs Journal* 6 (9): 389–395. <https://doi.org/10.54648/gtcj2011048>.
- Patel, Parimal & Keith Pavitt. 1994. "National Innovation Systems: Why They Are Important, and how They Might Be Measured and Compared". *Economics of Innovation and New Technology* 3 (1): 77–95. <https://doi.org/10.1080/10438599400000004>.
- Como citar:** Malta-Kira, Thomas. 2023. "Legislação sobre segurança nacional e sistemas nacionais de inovação: uma tendência internacional para controles de investimentos". *CEBRI-Revista* Ano 2, Número 7: 99-116.
- To cite this work:** Malta-Kira, Thomas. 2023. "National Security Legislation and National Innovation Systems: An International Trend Towards Investment Controls." *CEBRI-Journal* Year 2, No. 7: 99-116.
- DOI:** <https://doi.org/10.54827/issn2764-7897.cebri2023.07.03.05.99-116.en>

Submitted: 18 de setembro de 2023

Accepted for publication: 2 de outubro de 2023

Copyright © 2023 CEBRI-Journal. This is an Open Access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original article is properly cited.