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Investment Screening in the Defence Sector: Promoting National Security and Neoliberalism

by Neil Noronha

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About CELIS Non-Papers

The CELIS Non-Papers on Economic Security is an occasional papers series published by the CELIS Institute gUG, Berlin, offering expert analyses and insights into pressing issues at the intersection of economic security, open markets, and competitiveness. Authored by scholars and practitioners, these non-papers delve into topics such as investment screening, supply chain vulnerabilities, foreign subsidies, sanctions, energy security, and other areas of economic security, providing thought-provoking perspectives to inform policy and practice.

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CFIS 24 Panel 6

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A. Introduction

This non-paper reflects on the CFIS 24 panel discussion on investment screening in the defence sector. It examines how governments and industry define critical sectors, the importance of cooperation in shaping effective screening regimes, and the challenge of balancing security with openness. The panel also considered the impact of foreign competition and emerging technologies such as AI on future screening practices.

B. Summary of Panel Proceedings

The session began with panelists highlighting their professional backgrounds—a rather diverse collection of individuals from government, industry, and the military—in relation to the topic. During opening remarks, they touched upon unique challenges that each of them has encountered with investment screening in the military sector. Some had to grapple with its foreign policy implications as their countries navigated complex bilateral relationships and multilateral pushes for continent-wide integration. Others were acute to the difficulty imposed on the private sector, which must constantly adapt to the ever-expanding regulatory environment. Lastly, some had to manage the interests of various political constituencies, who view investment screening in this sector differently than policy decisionmakers. Government officials are concerned about the country's national security. A political interest group contrastingly may care that heightened screening will restrict capital circulation within a region for which it advocates.

Three additional rounds of back-and-forth questioning followed, with the panel focusing on three aspects of investment screening in the military sector. First, they attempted to scope the regulatory environment in defining what constitutes the defense sector. Those representing their national governments took a more expansive view of the concept given their protective mission; those from the private sector wanted to circumscribe the field. Resolving this tension is important. Misalignment in expectations surrounding the reach of investment screening may lead to one of two outcomes, both of which weaken the effectiveness of such a regime. The private sector, holding an under-inclusive view of what fields fall under such screening's purview, may not comply with government regulations. Alternatively, if it holds an over-inclusive interpretation given penalties for non-compliance, it may proactively restrict its operations, hurting the economic growth of the country.

Second, the panel discussed how countries should institute investment screening in this sector. Everyone agreed that an optimal regime involved an interdisciplinary and cross-functional approach that leveraged a diverse group of professionals when deciding upon proposed investments on a case-by-case basis. Moreover, panelists held that national governments should work cooperatively with the private sector in right-sizing investment screening so that these regimes elicit proactive, incentive-based responses versus reactive, compliance-focused adherence. The concurrence around cooperation is certainly welcomed and could reduce misalignment in expectations as raised previously.

Third, panelists debated about the effects of investment screening in the military sector in terms of the balance between fostering an open investment climate and safeguarding national defense. A diversity of opinions, sometimes conflicting with one another, arose during this discussion. Some viewed their role in this field through the lens of one end of the spectrum, either in promoting business or in defending national interests. Others, on the other hand, wanted to occupy the middle ground, leveraging regional integration to disperse the costs of not exclusively embracing free trade or national security. Holding either a pro-security or pro-business position proves problematic. Reactionary opposition from the government or business community will cause a divergence in investment screening efforts that will yield sub-optimal results. A country may successfully deter corporate espionage or undue foreign ownership control, but capital flight or diversion will occur. Likewise, a country may prioritize openness to foreign direct investment, spurring its economy to grow; however, its vulnerability to foreign influence from these investments may reduce its military advantages in defending its interests.

To conclude, the panelists answered questions from an engaged audience. Particularly, they discussed about how Western and West-aligned countries needed to structure their investment screening regimes in this sector to compete against Russia and China, who are offering favorable investment terms to non-aligned countries in the Global South. Additionally, panelists opined on the impact of artificial intelligence (AI) in investment screening. Some argued that Western or West-aligned militaries must better promote civil-military fusion under an AI integration strategy in order to keep pace with China, which has adopted this approach.

C. Recommendations and Best Practices

Based upon this panel, national governments, international organizations, and civil society should consider the following policy recommendations and best practices:

1. *Proactive Multi-Party Discussions:* Civil society should organize forums and conferences where the national government, industry, the military, and political interest groups can meet to discuss the threat landscape and brainstorm mitigation ideas. Fostering these discussions will allow all parties involved in investment screening in the military sector to align expectations over regulatory actions.

2. *Collaborative Training and Preparation:* The national government should, after announcing new procedures or administrative rules to investment screening in the military, conduct implementation workshops with relevant private sector entities. These convenings should include table-top exercises where industry representatives and government officials run through scenarios of potential screening situations. In turn, companies can understand the intent, purpose, and use of new administrative rules and procedures for investment screening in the military sector. They will be in a better position to assist national governments.

3. *Incentivizing Cooperation:* The national government should offer regulatory and monetary incentives to companies that go beyond just complying with regulations to uphold the investment screening regime in the military sector. Namely, whoever voluntarily discloses information about prospective investment transactions in this field (e.g. identities of the parties, background on the supply chains involved, etc.), the national government should afford that entity safe harbor in proceeding with the transaction in the event that regulators

do not raise any issues. Alternatively, the national government could consider these gestures of goodwill when imposing a penalty on a company found to have committed a violation. This system engages companies to work proactively and synergistically with national governments over investment screening in the military sector.

4. *Regularized Feedback Loops*: The national government should engage in periodic consultations with industry (e.g. quarterly) to assess the efficacy and effectiveness of administrative rules and procedures for investment screening in the military sector. A prospective session could involve officials surveying private entities, followed by a sit-down where a national government could review the results of the survey and listen to concerns from the industry. Such active listening would enable investment screening to be iterative, subject to rightsizing that meets the needs of the national government and assuages the concerns of the regulated.

5. *Institutionalization of Exchange Program*: Industry and the national government should host an exchange program where select employees of each can spend time working for the other side. This integrated approach to collaboration over investment screening in the military sector allows both parties to develop an understanding of how their counterparts operate and view national security threats in this field. In turn, that shared understanding can materialize into more responsive regulatory actions that deliver results in pursuit of each side's objectives.

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The views expressed in this Non-Paper are solely those of the author(s) and do not necessarily reflect, nor can they be attributed to, the panel members, chair, or any other participant in CFIS 24, or the CELIS Institute. This document represents the discussions as recorded and interpreted by the panel sherpa.

Panel members were Sebastian Gräfe (Deputy Head of Unit for Investment Screening, Federal Ministry of Defence (BMVg), Berlin), Dominik Eisenhut (Senior Legal Counsel, Airbus SE, Toulouse), Myrto Pantelaki (Legal Counsel, General Directorate for Defence Investments and Armaments (GDDIA), Hellenic Ministry of Defence, Athens) and Jun Nagashima (Ambassador Extraordinary and Plenipotentiary of Japan to Burkina Faso, Ouagadougou). The Panel was chaired by Thomas Feddo (Founder, The Rubicon Advisors; Former Assistant Secretary of the Treasury for Investment Security (CFIUS), Washington, D.C.). Panel Sherpa was Neil Noronha (CELIS Institute).

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About the CELIS Institute

The CELIS Institute is an independent non-profit, non-partisan research enterprise dedicated to promoting better regulation of foreign investments in the context of security, public order, and competitiveness. It produces expert analysis and fosters a continuous trusting dialogue between policymakers, the investment community, and academics. The CELIS Institute is the leading forum for studying and debating investment screening policy.

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