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National Security Investment Reviews

Issue 1: The Defense Innovation Readiness Gap Is Widening

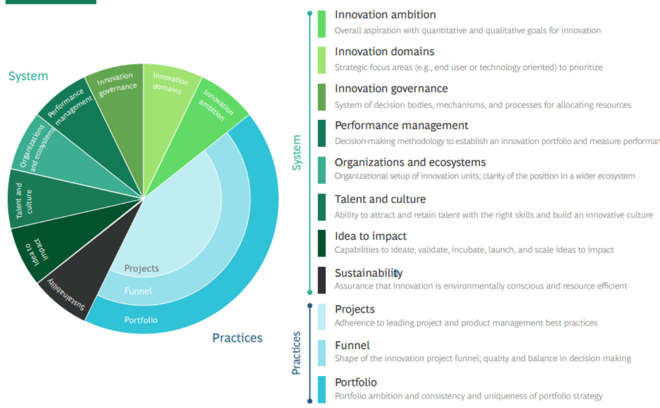
Source: https://www.bcg.com/publications/2023/defense-innovation-readiness-gap-widening

Considerations: Notably – the countries identified in this report as "Creators and Expanders" (those who focus on big efforts to create new capabilities) are: **United States, China, and Russia**.

In late 2022, the Munich Security Conference (MSC) and Boston Consulting Group (BCG) conducted a second comprehensive review of defense innovation activities across 59 countries. The MSC-BCG study team sent a survey to the same group from the 2021 study of 59 ministries of defense (MoDs), the European Union, and NATO to assess innovation readiness across 11 dimensions, enabling MoDs to compare their current innovation readiness to their previous year's performance, and to that of their private-sector counterparts

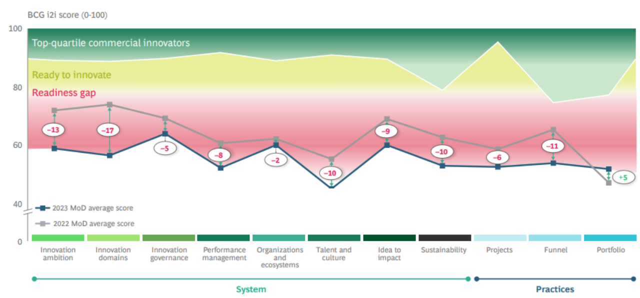
The results show that the defense innovation readiness gap significantly widened in the year since our first study. Across 10 of 11 dimensions of readiness, MoDs fell below last year's results, by an average of 8 percentage points.

Exhibit 1 **The 11 Dimensions of Innovation Readiness**



Sources: BCG Most Innovative Companies Survey, 2022; BCG analysis.

Exhibit 2 **Ministries of Defense Report a Widening Innovation Readiness Gap**



Sources: BCG Defense Innovation Survey, 2022, 2023; BCG Most Innovative Companies Survey, 2023; BCG analysis.
Note: The BCG i2i benchmark reveals an organization's relative strength on a 100-point scale that reflects best-practice maturity. Organizations that earn a score 80 or above are deemed ready to realize their innovation aspirations.

Recommendations:

1. Rebalance the innovation portfolio with a greater focus on operational outcomes and fielding fast.

2. Expand the definition of interoperability beyond the development of new technologies to include acquisition, operations, and sustainment of legacy products.

3. Access untapped value and de-risk programs through superior insight into supplier economics.

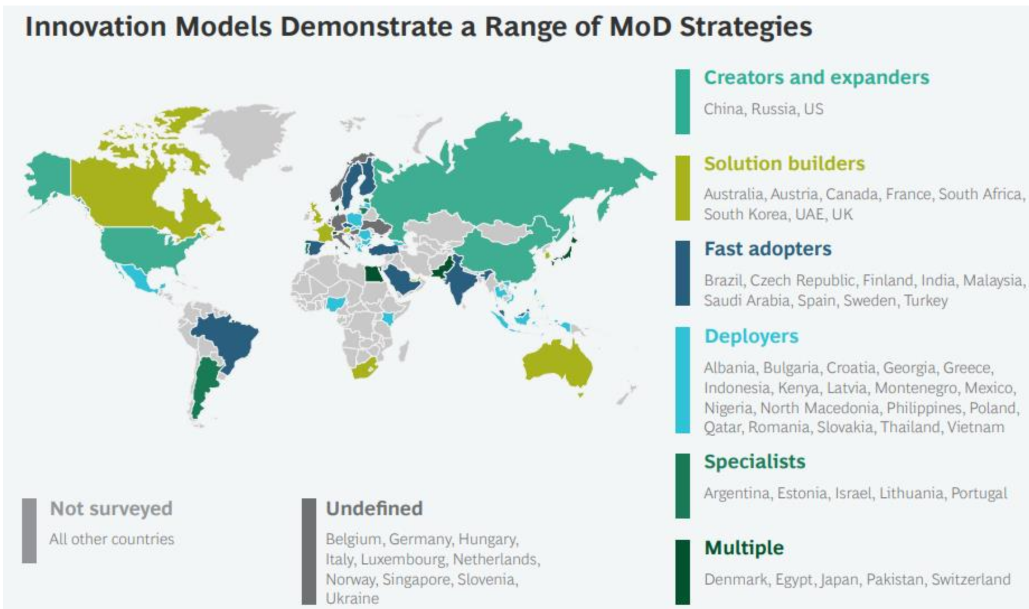
4. Reinforce cyber defenses across the entire innovation ecosystem.

5. Benefit from the increasing investments in climate and sustainability innovations.

Example of Potential for a new Wave of Interoperability: The UK, Japan, and Italy are collaborating on a sixth-generation fighter jet, the Global Combat Air Programme, with an opportunity to set shared standards with other fighter jet programs, including Airbus's Future Combat Air System and various US programs. Similarly, France and Germany are collaborating on a European Main Battle Tank that uses components from currently deployed tanks (the chassis and hull of the German

Leopard 2A7 and the turret of the French Leclerc). By adopting these common features, the countries may be able to establish rapid maintenance, repair, and operations hubs across Europe for all three tanks.

Conclusion: Efforts to close the innovation readiness gap cannot succeed unless MoDs implement them at every level of the organization. Too often, the people implementing day-to-day processes do not take up leadership strategy and end-user priorities, which results in strategic goals being set by bureaucracy instead of leadership. Working groups, long-term studies, and directives without an implementation roadmap will not deliver the behavior changes needed across the entire organization to improve innovation outcomes.



Issue 2: Tightening Foreign Investment Screening Undermines National Security

Source: https://thehill.com/opinion/national-security/3811465-tightening-foreign-investment-screening-undermines-national-security/

Considerations:

This ability to attract foreign investment strengthens the U.S. economy and its national security, helping to grow U.S. capabilities in areas such as semiconductor manufacturing, artificial intelligence, and quantum computing, all important security technologies. Some foreign companies even help to protect our borders — a U.S. subsidiary of the French company IDEMIA, for example, provides identity verification machines used in airport security screening lines.

Moves to restrict investment in an overly broad fashion, though, now threaten to undermine this comparative advantage. The Trump administration gave new authorities and resources to the Committee on Foreign Investment in the United States, and with these new powers — and dark government warnings about "adversarial capital" — the committee has become an impediment to investments from around the globe.

The new investment screening rules instead create broad uncertainty about which investments are proper, with committee approval as the mechanism to resolve that uncertainty. Screening of foreign investors often is required even when the recipient companies and technology are of foreign origin. The new rules unnecessarily require lawyerly reviews of thousands of transactions each year, including from investors in Europe, Japan, and other close U.S. allies.

These investment screening rules often keep talent and capital outside the United States, rather than protecting what is inside. Consider, for example, a German software company contemplating moving its headquarters to the United States. If that company anticipates relying on investments from around the globe, the costs and limitations of the screening rules might deter the relocation.

The potential long-term consequences are worrisome. Talent is globally dispersed and technology has enabled collaboration to occur virtually everywhere. Investors find exciting business ideas wherever they originate. The share of venture capital dollars flowing to U.S. start-ups accordingly has fallen from over 80 percent to about 50 percent in less than two decades. Our economy benefits from the dynamism created by venture capital; we should want more, not less.

Rather than cultivating America's ability to entice foreign investments and foreign companies, though, the U.S. government continues tightening foreign investment screening, weakening U.S. comparative advantages. It will be ironic and tragic if the next great semiconductor, artificial intelligence, or quantum computing companies — merely illustrative of technologies that can make significant contributions to national security — are deterred from growing roots in the United States because of tightened investment screening rules.

Issue 3: The U.S. Government Should Try Harder to Minimize Costs of China Defensive Measures

Source: https://www.lawfareblog.com/us-government-should-try-harder-minimize-costs-china-defensive-measures

Considerations:

A recent review of scientific papers has led Stanford University-affiliated researchers to a worrisome conclusion: The U.S. government's efforts to stay ahead of China in a technology race by restricting cross-border collaboration have "slowed American advancements."

Regardless, concern about competition from China is so ubiquitous and acute among lawmakers and in the federal government that these and similar warnings—emphasizing that U.S. measures against China have costs that policymakers should try to minimize—are whistles in the wind. Virtually the only critique heard, whether from the political right or the left, is "do more."

There are other acute problems with CFIUS. I've written elsewhere about the severe problems resulting from the combination of CFIUS's fragmented committee structure, confidentiality regarding decision-making, and lack of judicial oversight. For example, no identified senior official takes responsibility for CFIUS decisions, which are said to be decisions "of the committee."

Exhibit A: The Unmitigated Costs of the CFIUS Mandatory Filing Rules

As a former CFIUS official and longtime private-sector attorney advising clients (from the U.S., Europe, China, and elsewhere) about investment screening issues, these mandatory filing rules seem particularly difficult to justify.

The mandatory filing rules do not provide any increased authority to CFIUS to review any transaction of concern. There is no indication that the mandatory filing rules have enabled CFIUS to take adverse action (for example, blocking a deal) that CFIUS would not have taken if those rules did not exist.

The mandatory filing rules for investments in critical technology are not required by statute, yet CFIUS repeatedly has declined to sunset the rules or make them less cumbersome. Why?

Beyond Exhibit A

There are other acute problems with CFIUS. I've written elsewhere about the severe problems resulting from the combination of CFIUS's fragmented committee structure, confidentiality regarding decision-making, and lack of judicial oversight. For example, no identified senior official takes responsibility for CFIUS decisions, which are said to be decisions "of the committee."

Against that backdrop, and in the current national security environment in which concerns about China dominate, the hundreds of individuals who may be involved in committee decision-making are incentivized to give dispositive weight to often-remote China-related risks—even when the investor is linked to China only in an attenuated manner (for example, a South Korean investor deriving significant profits from China). These officials have no incentive to give weight to the long-term benefits of maintaining an investment climate that welcomes foreign participants. The officials do not have to publicly justify their decisions and, unlike in administrations from Reagan through Obama, there is no longer a pro-investment contingent within CFIUS that is willing to say "that transaction presents such a remote risk that CFIUS intervention is not warranted, as it does not outweigh the benefits of maintaining an open investment policy."

Further, CFIUS defensive measures are not the only ones giving rise to reasonable concerns about unmitigated costs. Commenting on a new set of draconian export controls, the U.S. Semiconductor Industry Association's recent report emphasizes that American leadership depends on free trade and that the U.S. "has the most to lose from proliferating restrictions." The pending "outbound screening" rules, which would limit U.S. firms' investments in foreign companies that have ties to China or Russia (but would not limit investments from non-U.S. firms), have the potential to curtail even further U.S. cross-border collaboration. Some commentary has emphasized that the U.S. "would be one of only a handful of advanced economies with industry specific outbound investment restrictions distinct from traditional sanctions regimes" if the pending rules are implemented.

Reason to Worry

With the U.S. representing less than five percent of the global population, U.S. innovation depends on magnetism: the ability to draw inward and to leverage global capital, talent, and innovation. On the one hand, the benefits derived from drawing resources inward and from international collaboration are, unfortunately, often long term and not easily perceptible. On the other hand, defensive measures are popular even when the costs of these measures threaten to outweigh the benefits.

Different defensive measures have different costs and benefits, and, perhaps, some are justified. But the CFIUS mandatory filing rules provide reason to worry that national security policymakers are not considering, or are grotesquely discounting, the costs of some defensive measures and are not trying seriously to mitigate those costs. The tension surrounding this issue—reflected in the proliferation of defensive measures—is now so high that there seem to be few political participants willing to consider the costs of declining U.S. magnetism. That decline is likely to continue, undermining the very advantages the government seeks to protect.

Issue 4: Rubio Seeks Pledge From Biden For No Federal Dollars To Partnership Between Ford, CCP National Champion

Source: https://www.rubio.senate.gov/public/index.cfm/press-releases?id=26D9FBA2-BFD2-4D61-84B6-A3A82C598CFE

On February 13, 2023, the Ford Motor Company and Chinese national champion Contemporary Amperex Technology Co. Limited (CATL) announced an agreement to build electric vehicle batteries in Michigan. This deal will only deepen U.S. reliance on the Chinese Communist Party for battery tech, and is likely designed to make the factory eligible for Inflation Reduction Act (IRA) tax credits.

U.S. Senator Marco Rubio (R-FL) sent a letter to U.S. Secretary of the Treasury Janet Yellen, U.S. Secretary of Energy Jennifer Granholm, and U.S. Secretary of Transportation Pete Buttigieg calling for an immediate Committee on Foreign Investment in the United States (CFIUS) review of the licensing agreement between Ford and CATL. In the letter, Senator Rubio also requested a commitment from the Biden Administration not to support CCP efforts by providing tax credits or other funding for the deal.

- "I am alarmed at Ford's plan to establish a large, Michigan-based factory, structured as a wholly owned subsidiary that licenses its technology from CATL. As such, I write to request a Committee on Foreign Investment in the United States (CFIUS) review of the licensing agreement, as well as demand that no federal funds – especially monies or tax credits granted via the *Inflation Reduction Act* (P.L. 117-169) – go to enrich PRC national champion CATL, or any other Beijing-supported company, directly or indirectly."

The deal announced will reportedly leave ownership of the plant and land on which it is constructed in Ford's hands, while CATL will own and supply critical technology involved, including lithium iron phosphate cathodes, via a licensing agreement. The exact structure of this arrangement has yet to be reported, but policymakers should be clear-eyed about one takeaway: if Chinese companies like CATL are able to exploit both Chinese and United States incentives for battery and EV technology through clever corporate arrangements, then there is no use in investing federal funds toward industrial development in the first place. Taxpayer dollars should never be used to support PRC champions.