INSS Insight No. 1229, November 19, 2019

A Regulatory Mechanism to Oversee Foreign Investment in Israel: Security Ramifications

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After lengthy groundwork by the National Security Council, the Ministry of Finance, and the National Economic Council, Israel's political-security cabinet decided to establish an advisory committee to examine national security issues as part of the approval process for foreign investments. The decision comes as a result of American pressure and Israel's fears of damage to the strategic relations with the United States, after Washington made it clear that it expects Israel to change its stance on Chinese activity in the state. The decision to establish a foreign investment oversight mechanism is an important and necessary step, especially in light of the strategic competition between the United States and China and the increasing oversight of Chinese investment across the Western world. However, in order for this mechanism to work in a balanced and effective manner, the Israeli government must define clearly which sectors will require examination by the committee; guarantee that the security and intelligence agencies provide the committee with ongoing professional support; and ensure that this mechanism is free from political considerations.

On October 30, 2019, Israel's political-security cabinet decided on the establishment of an advisory committee to examine national security issues within the approval process for foreign investments. This decision was made after lengthy groundwork led by the National Security Council (NSC), the Ministry of Finance, and the National Economic Council. It was decided that senior representatives from the Ministry of Finance, the Ministry of Defense, and the NSC, as well as observers from the Ministry of Foreign Affairs, Ministry of Economy, National Economic Council, and the Ministry of Finance would sit on the advisory committee. The committee aims to help regulators integrate national security considerations in what are primarily financial and economic considerations in the approval process of foreign investments. However, approaching the committee will be on a voluntary basis by regulators who are experts in the respective fields of the investment – once an investment meets the criteria that require its review and at the discretion of the regulators – while transactions that do not require government authorization will not be brought before the committee at all.

The decision comes as a result of American pressure and Israel's fears of damage to the strategic relations with the United States, after Washington made it clear that it expects Israel to change its stance on Chinese activity in the state. In the shadow of the "trade war" between China and the United States, senior administration officials have put pressure on their Israeli counterparts to accelerate the establishment of a foreign investment oversight mechanism, similar to a parallel mechanism in place in the United States (CFIUS). US officials have expressed concern about Chinese involvement in the Haifa Port, fifth generation (5G) cellular communications infrastructure, and the Israeli hi-tech sector, which currently remains outside the committee's scrutiny, a situation that could lead to continued tensions with the US administration.

As in other countries, the discussions leading to the decision to establish the mechanism were characterized by inherent tension between economic and security agencies. While the security agencies, led by the NSC, stressed concerns about foreign influence, security risks, and in particular, potential damage to relations with the United States, the Treasury and other economic bodies fear rigid oversight will scare away investors and might even encourage a brain drain. Therefore, the decision reflects a certain balance between security and economic considerations.

To be sure, there are a number of differences between the committee to be set up in Israel and parallel committees operating in developed countries. First, the Israeli committee will not operate within the framework of legislation on foreign investment, while parallel committees that operate, inter alia, in the United States, Australia, Canada, and Germany operate within a relevant legal framework dealing with foreign investment. Second, the role of the committee in Israel will be to advise regulators, while the role of parallel committees in Western countries is to advise senior political echelons. Third, while reporting to the Israeli committee will be voluntary, in parallel committees abroad there is often an obligation to report foreign investment, especially by entities controlled by foreign governments or likely to affect certain economic sectors. Fourth, it was not announced whether the Israeli committee will look differently at foreign investments by entities controlled by foreign governments. It is often the case with committees operating in Western countries that they automatically examine investments coming from foreign government entities, or set a lower threshold for examination if investments originate from government entities.

As announced, foreign companies wishing to invest in Israel in the financial, communications, infrastructure, transportation, and energy sectors will need regulatory approval; the hi-tech sector and related offshoots are significantly absent from the list. Investment policy in the Israeli hi-tech sector is marked by tension between the desire to attract foreign investment and the risks posed by the involvement of foreign entities and their control of advanced technologies. On the one hand, Israel's continued economic growth is largely dependent on the growth of the hi-tech sector, which relies on foreign investment from various countries, including China. On the other hand, the hi-tech sector is a battlefield in the strategic competition between the US and China: China strives to become a leader in technological innovation in the coming years, while the United States seeks to maintain its superiority, in part by preventing the transfer of advanced technologies to China. Moreover, today there are various civilian technologies, especially artificial intelligence, cyber security, big data, and robotics that are in a gray zone as their civilian dimension is growing even as they are also applicable to military needs (and thus can be considered as dual-use).

Therefore, on the one hand, the exclusion of the hi-tech sector from the committee’s authority is in line with the preferences of the private actors in the Israeli hi-tech market and the government's economic ministries, which are not interested in government intervention in foreign funding processes. On the other hand, China's ambitions when it comes to developing its economy and becoming an innovative technological power are an economic challenge for Israel in the medium to long term. One of the ways China plans to achieve this goal, as expressed in the “Made in China 2025” strategic plan, is the purchase and adoption of foreign technologies and their adaptation to the Chinese market, which will enable the development of a local, Chinese, knowledge base. It is thus clear that China is not just a customer for Israeli technologies and a partner for investments in Israel, but also a direct competitor of Israel with regard to everything connected to technological innovation, inter alia, by adopting and improving technologies originating in Israel.

Recommendations

The decision to establish a foreign investment oversight mechanism is an important and necessary step, especially in light of the strategic competition between the United States and China and the increasing oversight of Chinese investment across the Western world. However, in order for this mechanism to work in a balanced and effective manner, the Israeli government must act on several levels. First, Israel must define clearly and distinctly which sectors will require examination by the committee, which will not, and which are in gray and/or emerging fields that will require reconsideration from time to time. This should be coordinated with the United States. Therefore, in the process of updating and adjusting, which is scheduled to take place in another six months when the cabinet reconvenes on the issue, it would be desirable to explore ways to manage risk from foreign involvement in the hi-tech sector as is the practice in many countries, including the United States, which identifies it as a center of gravity in its national security. Thus, Israel should consider adding a criterion for a more in-depth examination and according to a lower threshold of foreign investment by companies controlled by foreign governments. One of the goals of establishing a supervisory mechanism for foreign investments is to reduce the risk of economic and political levers being created by foreign governments, which would impair Israel's independence, sovereignty, and freedom of action. Therefore, closer supervision of investments made by government companies will improve the potential for responding to these risks.

Second, for the committee to work effectively, the security and intelligence agencies must be able to provide it with ongoing professional support. In order to provide relevant and in-depth advice, the knowledge of the various government bodies regarding the business, economic, and strategic activities of foreign players must be promoted, with an emphasis on China, whose share in the global economy and the Israeli economy is growing steadily. Government bodies must gain knowledge of the characteristics of the Chinese domestic economic arena, in particular business-party relations in China and the use of economic means to achieve diplomatic or political goals. These are mainly reflected in the activities of state-owned Chinese enterprises (SOEs) abroad and in formal and informal relations of private companies with the Chinese Communist Party. Furthermore, a regularly updated knowledge base on China's medium to long term policy should be established. Israel should consider examining China’s five-year plans, local Chinese development programs, and initiatives with international implications. Israel can use relevant US government and academic bodies to build this knowledge base, and to expand cooperation between the two countries on this issue, including intelligence cooperation, and deepen the knowledge infrastructure required for such consulting and oversight activities.

Third, it must be ensured that this mechanism is free from political considerations and strives for a proper balance between risks that may arise from foreign investment, and the desire to continue to enable liberal and beneficial investment policies in the Israeli economy. Consequently, the committee must not constitute a constraining and complicating factor that will cause unnecessary damage to vital investments for the Israeli economy, which is itself a fundamental pillar of its national security. Finally, beyond operating a professional mechanism for regulating foreign investment, the next Israeli government must formalize its oversight and control processes for managing policy vis-a-vis the world great powers.