The adoption and diffusion of international economic policy: the case of foreign investment screening [*]

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Abstract

This paper investigates the rise of foreign investment screening mechanisms (ISM), a new policy friction in the global economy, over the last two decades. Originally conceived as a policy to regulate the foreign control of sensitive industries for national security reasons, ISMs have proliferated across broader sectors of national economies. We formally analyze the sectoral-level choice of ISM adoption in a model that emphasizes norms within networks of international relations as the driving force behind the diffusion of ISMs. We argue that as leading economies adopt ISMs across sectors of the economy, the cost of violating norms of economic openness decreases for the other networked economies, and ISM adoption spreads. We then empirically scrutinize the role of network effects using a unique country-sector-level panel data set on ISM adoption. Examining a broad variety of network linkages – bilateral trade relations, membership in the EU, geographic and political distances, and linkages to the world's major economic powers – we conclude that network effects explain ISM adoption, and that economic linkages are more important than political linkages.

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1 Introduction

The world's economies have become increasingly interconnected over the past decades, as lowering barriers to the free flow of economic factors and economic outputs had been a priority of the economic world order that emerged after the second world war.[1] However, the economic growth potential that was unlocked by globalization has come at some cost for countries, not least due to the potential security risks of loosing sovereign control over strategic sectors. Foreign investment screening mechanisms (ISMs) emerged as policy instruments that domestic governments could use to mitigate the security tail-risks of foreigners acquiring domestic assets and companies.[2]

Economists have long championed the growth-enhancing allocation of economic factors across diverse national economies that globalization allows for and indeed laissez-faire international economic policies had become the norm in international economic relations (Simmons and Elkins, 2004).[3] Recently, domestic politics have brought "de-globalization" into policy debates in response to a political backlash against mainstream parties that have supported the liberal economic world order (Walter, 2021). Trade wars and border fences have salience in domestic political debates, make international headlines, and grab the attention of social scientists. However, there is less attention paid to the more subtle, bureaucratic means that states have adopted to protect their economies from international risks such as policies regulating foreign investments in domestic companies and infrastructure.

Originally conceived as a policy to regulate foreign control of security-sensitive industries, foreign investment screening mechanisms have proliferated across broader sectors of national economies. The rise of ISMs introduces a friction in the globalized economy, where the prevail-

[1]Economic integration into a "globalized" economy had been largely a response to that catastrophic war, as integrated (and growing) economies were thought to be less likely to engage in future violent conflicts (Monnet, 2014).

[2]The majority of OECD governments with an ISM screen for risks to public order or security. In most states, these terms are not defined conclusively which leaves some leeway to the controlling authority. Some states furthermore screen for the economic effects of FDI, namely Australia, Canada, Mexico and New Zealand (SERI, 2022; Bauerle Danzman and Meunier, 2021).

[3]In the 1990s and 2000s, governments competed to attract international investment, often focusing on the positive aspects of foreign investments for the domestic economy: access to international production networks and markets, creation of new and higher wage jobs, transfer of capital, knowledge, skills, and technology. The effects of FDI are not unambiguously positive, however (see, e.g., Graham and Krugman 1995; Borensztein, De Gregorio and Lee 1998; Girma, Greenaway and Wakelin 2001; Helpman 2006; Driffield, Love and Taylor 2009; Alfaro 2017; Navaretti and Venables 2020).

ing norm had been for liberalized exchange. We study the diffusion of ISMs within a rational choice-theoretic formal model where diffusion of the policy operates through a movement away from the norm of liberalism that prevails in a country's network of international relations. We then pursue an empirical investigation in a large-N econometric analysis that employs a unique country-sector-level panel data set to empirically investigate the network effect.

ISMs give states the "ability to restrict or condition the access of certain individuals to certain assets, in particular enterprises or parts thereof, through acquisition- or ownership controls" (Pohl and Rosselot, 2020, 11). Instead of prohibiting investments by certain types or origins of investors altogether, these dedicated government institutions examine, scrutinize, impose conditions upon, and potentially prohibit planned foreign acquisitions to mitigate threats to national security or public order, and, in some countries, are checked also for further criteria like benefits to the national economy.

Traditionally, investment screening was motivated by security risks related to the physical presence of foreigners in sensitive locations (e.g., proximity to border and defense facilities) and foreigners' investments in sensitive enterprises (mostly defense manufacturing). With the privatization of infrastructure in some advanced economies in the 1980s, critical infrastructures were also recognized as sensitive assets. However, many countries now recognize new channels of risk transmission, implying that new sectors and new types of companies are under scrutiny. These include advanced, dual use, and network technology, sensitive (personal) data generation and holding, food security, and media assets.[4] Since 2007, 23 of 38 OECD countries have created new ISMs to manage risks to essential security arising from foreign investments (seeFigure 1). Pohl and Rosselot (2020, 15) estimate that up to 60 percent of global FDI flows are now potentially subject to national security related review.

While states clearly have the sovereign right to implement such restrictions, their usage does go against norms of international economic relations from earlier in the 21st century, especially

[4]Chan and Meunier (2021) use interviews with high-level bureaucrats, an elite survey and an empirical analysis to show that officials in countries with higher technological level are more favorable towards an EU-wide investment screening framework because of concerns about unidirectional transfers of technology. Countries with Chinese investments in high-technology sectors also tended to support the EU screening mechanism (Chan and Meunier, 2021) and are more likely to adopt an ISM (Eichenauer, Dorsch and Wang, 2021).

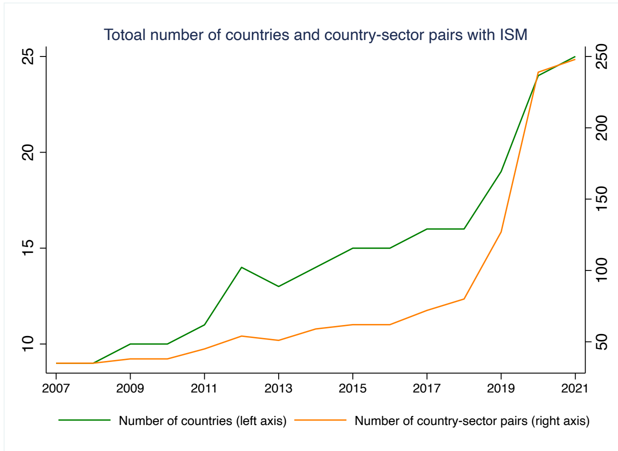

Figure 1: Fast growth in sectoral investment screening. Source: Data from Bauerle Danzman and Meunier (2021), own representation.

as the breadth of sectors screened has gone beyond traditional security concerns.[5] Besides the potential efficiency costs of screening FDI, our analysis highlights the role of intangible costs for states that arise from violating norms within their network of international economic relations that can explain the diffusion of ISM adoption.

We study the diffusion of ISM adoption within a rational choice-theoretic formal model. We treat screening as a way to reduce the risk of damage created by foreign investment, as a form of self-protection *à la* Ehrlich and Becker (1972). We then model the implementation of an ISM as the adoption of a technology that allows for screening investments above a certain ownership threshold. **Consistent with the characteristics of ISMs, we model it as a decision to screen (although with different intensities) all the foreign investment – whatever their country of origin – above a given threshold in one sector. Our model then differs from the classical two-player games with strategic interaction (e.g. Grossman adn Helpman on trade tariff). Screening then entail three kind of cost: a political cost (both national and internationally) for setting an anti-globalization policy; a administrative cost of having to investigate all the files above the threshold; and a screening-effort cost that can be adjusted depending on the file (and in particular on**

[5]The international law for cross-country FDI as codified in the General Agreement on Trade in Services (GATS) and the OECD liberalization guidelines allow for limiting foreign investments to protect public order and essential security interests (SERI, 2022).

the country of origin. The theoretical model emphasizes the role of norms in international relations, based on the assumptions that (i) ISMs provide security benefits to the home country, though may reduce growth rates; (ii) adoption of an ISM in a sector violates an international norm of economic openness; and (iii) there are political (domestic and international) costs to violating the international norm, which are decreasing in the adoption behavior of countries that are "close" in the home country's international network.[6] In line with the network economics literature, our setting in which the norm-deviation cost of adoption is decreasing in the adoption of other countries leads to a coordination game. Assuming countries do not impact each other symmetrically (Morris, 2000), agents in a network adopt a behavior if a least a given fraction of her neighbors do so (see Jackson and Storms, 2019, for a discussion).[7][8] Analysis of our model identifies how network effects are important for understanding when and for which sectors countries will adopt an ISM.

Bringing network models of adoption to data, previous work has analyzed policy adoption by countries with prominent examples being the diffusion of educational and human rights policies (: Meyer et al. 1992; Simmons 2009; Greenhill 2010) and at the individual level, e.g., the role of networks and language in welfare participation (Bertrand, Luttmer and Mullainathan, 2010), peer effects on unhealthy behavior (Powell, Tauras and Ross, 2005; Fortin and Yazbeck, 2015), and peer effects on commuting decisions (Lambotte et al., 2022). We adopt a similar strategy to analyze how international economic relationships influence the adoption of ISMs.

We empirically scrutinize the theoretical predictions of our model using new data on sectoral ISM adoption from 2007 – 2021 for Organization for Economic Cooperation and Development (OECD) countries (Bauerle Danzman and Meunier, 2021) and completed by us for EU countries that are not also members of the OECD. We analyze ISM adoption at the sector-country level using linear probability models that control for own screening experience in other sectors and in-

[6] Costs of norm violation may regard both international and national concerns. On the international side, it can correspond to (non tangible) cost in terms of influence or reputation; whereas nationally it may reflect the political cost and benefits of anti-globalization policies when citizens observe the policy choices of "close" countries.

[7] There is some work on network effects in FDI decisions (Schoeneman, Zhu and Desmarais, 2022), but we are not aware of any studies that utilize network theory to understand regulating international economic relations.

[8] A more classical game-theoretic model – e.g. repeated prisoner dilemma with $n > 2$ players – would entail unanimous punishment of deviating country, which doesn't seem empirically relevant.

clude various fixed effects specifications (sector, country, and year in the baseline). To test for the hypothesized network effects, we have constructed network influence variables that capture the extent of sector-specific ISM adoption in a country's international network. We have considered a variety of ways to conceptualize the international linkages that inform the cost of norm violation by weighting adoption by existing observable types of networks – bilateral trade relations, membership in the EU, geographic and political distances, and actions of the world's major economic powers, to name a few. We begin the analysis at the country-sector level, before zooming in on annual data at the country-dyad-sector level.

We find that the adoption of an ISM in a given sector correlates with other countries' screening of the same sector in the past year but not with other countries' screening of other sectors, implying that there are sector-specific peer effects in screening rather than a general norm related to screening inward FDI. We find that EU countries are significantly influenced by the norm within the trading bloc but not elsewhere in the world, and that the strongest norm influences come from a country's major trading partners and the world's biggest economies. Concerning trading networks, we estimate that a unit increase in the trade-weighted network adoption rate in a sector increases the likelihood that a country also adopts in that sector by 7 percentage points. When a major economy adopts an ISM, we estimate an average dyadic effect of an increase in the likelihood that the home country adopts a an ISM in the same sector by 2 percentage points. Across a broad range of specifications, we find that economic network effects are more important than political network effects. International economic network effects even explain adoption better than domestic political pressure against globalization.

There is also anecdotal evidence that norms about ISMs have shifted and that governments consider the screening policy of other countries when deciding about adoption. For example, the European Commission proposed an ISM mechanism in 2011 with the intent of guarding against non-EU investors that would "close down businesses after having stolen all of their 'know-how"' (EC, 2011). Clearly sensitive to how implementing ISM would be perceived among their network of international economic relations, European Trade Commissioner Karel De Gucht cautioned against a screening system for investment at the EU level, recalling the multiple benefits of foreign investment (BibTEX: De Gucht, 2012). After the failed proposal of 2011, the EU has since adopted an FDI screening Regulation (2019/452) with massive support by the European parliament in March 2019.[9] Some years later in Switzerland, a government report on ISM adoption notes that many OECD governments have adopted or are in the process of adopting investment screening (SERI, 2022, 35- 36). The FDI policy of other countries is mentioned in (i) the context of the international attractiveness for FDI, and (ii) with regard to the likelihood of retaliation by the government of a company which sees its investment blocked. Finally, consider the argument made by the government of the United Kingdom in favor of FDI screening, in which they argue that relevant peers also implemented ISMs: "These reforms will bring the UK closer in line with other countries' regimes, and are taking place as many other governments are also updating their powers in light of the same technological, economic and national security-related changes" (BibTEX: UK White Paper 2018: 21). Although reporting on number of transactions screened, aborted, blocked, or modified is highly incomplete with public information requirements differing over time and across countries, the trend is clear: ISM caseload has increased sharply (Pohl and Rosselot, 2020).

We contribute to the emerging literature on the politics of investment screening mechanisms in two fundamental ways.[10] First of all, our paper provides the first formal theoretical framework for analyzing the choice of sectoral ISM. The theoretical framework more generally contributes to future political economic analysis of restrictive international economic policies that may have security benefits that come at economic cost for the domestic economy in terms of e.g., reduced growth. The second contribution to the investment screening literature is our focus on a network effect on the cost side of implementing an ISM. Modeling the effects of foreign influence in terms of costly norm violation is a novel angle to the more general literature that looks at how factors outside domestic politics shape domestic policies in advanced democracies (reviewed by Aidt,

[9] The EU regulation sets minimum standards for member states with an investment screening mechanism while not requiring the adoption of an ISM. It also institutes mandatory coordination which allows other member states and the EC to raise concerns related to specific investments in other EU states. However, the member state receiving the inward FDI remains the ultimate decision makers. Both Schill (2019) and Chan and Meunier (2021) expect that the framework regulation on investment screening is a first step towards more screening competences at the EU level.

[10] In addition to some key contributions (Graham, Marchick et al., 2006; Lenihan, 2018; Zimmerman, 2019; Schill, 2019; Canes-Wrone, Mattioli and Meunier, 2020; Chan and Meunier, 2021), there is much interesting work in progress (e.g., Bauerle Danzman and Meunier, 2021, 2017).

Albornoz and Hauk 2021).[11]

We also relate to a large literature in the social sciences on policy diffusion across political jurisdictions, mainly in political science (e.g., Simmons and Elkins 2004; Graham, Shipan and Volden 2013; Desmarais, Harden and Boehmke 2015; Gilardi 2016; Gilardi and Wasserfallen 2019; Baldwin, Carley and Nicholson-Crotty 2019; Gilardi, Shipan and Wüest 2021). The core question of this literature is why and how policy makers react to policy decisions made elsewhere, but implemented in a localized (or, decoupled) version (Meyer and Rowan (1977); Meyer et al. 1992; Rose 1993; Chorev 2012; Wasserfallen 2019).[12] The literature in political science has distinguished between several mechanisms of policy diffusion: (a) learning, (b) competition, (c) coercion and (d) emulation (: Braun & Gilardi 2006; Simmons et al. 2006; Shipan& Volden 2008; Gilardi 2012), though which mechanism is dominant has proven to be a difficult task (see Harden et al. N.d. for a recent attempt and discussion).[13]

Our empirical setting allows us to distinguish norm-related behavior from other policy diffusion mechanisms. First, the network effects that we identify cannot be attributed to policy learning, since the effects of implementing ISM are unobservable. Countries may learn about emerging risks in new economic sectors, but the sectoral level of our analysis allows the use of sector-, year- and country-year fixed effects to absorb common shocks that inform about new sectors holding security risks (e.g., biotechnology during Covid-19).[14] Second, the competition mechanism seems to apply more to race-to-the-bottom type policy diffusion, rather than restrictive policies as we consider here. Moreover, competition is generally thought to occur between neighboring jurisdictions (Harden et al., N.d.), and we do not find any evidence that geographic proximity of network linkages can explain ISM adoption. Third, coercion does not seem to apply, as international or-

[11] Aidt, Albornoz and Hauk (2021) focus on the international externalities involved with domestic policies and foreign countries' active forms of influence. In our analysis, the role of foreign countries' influence on domestic policies is more passive.

[12] Meyer and Rowan (1977) have developed a seminal explanation for this, arguing that policy makers aim to conform to dominant international norms, and they take domestic constraints into account by implementing legislation that is tailored to their specific contexts.

[13] These mechanisms describe the main force influencing policy makers: (a) by the non-political impact of policies elsewhere, (b) by policies of other units with which they compete for resources, (c) by the pressure from international organizations or other countries, and (d) by the perceived appropriateness of policies.

[14] The relevant information for ISM concerning risk of damage is specific to the country obtaining the inward FDI, so the mechanism through which the adoption of one country could inform another on its own risk would entail an important degree of correlation between each country's risk.

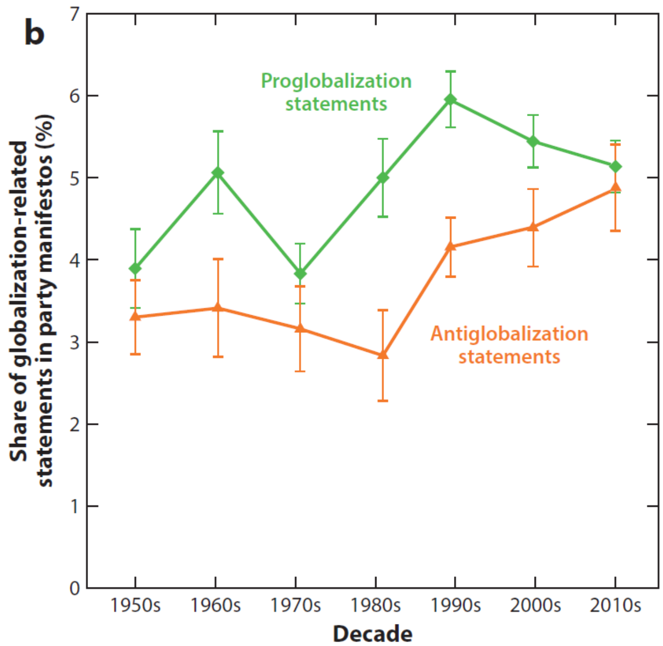

Figure 2: Partisan globalization discourse. Data come from the Parlgov database (Döring & Manow 2019) for vote shares and from the Comparative Manifesto Project (Volkens et al. 2019) for party discourse. Anti (pro)-globalization statements are calculated as the combined share of negative (positive) statements/quasi-sentences about internationalism, the European Union, and multiculturalism plus positive (negative) statements regarding protectionism and the national way of life as a percentage of the overall number of allocated codes per document. Source: Figure 2b in Walter (2021).

ganizations such as the WTO have their prior on reducing barriers to factor flows, rather than increasing them. Moreover, coercion would need to be country-, time- and sector-specific, which we do not observe. Concerning the fourth mechanism, Gilardi and Wasserfallen (2019) highlight that the political dimension of policy diffusion is understudied, especially regarding emulation.[15] If emulation drives the policy diffusion processes, then we would expect that leading countries exert the strongest influence over network linkages, and we do indeed find this to be the case in our estimations.

Since ISMs regained prominence in the mid-2000s, more countries have adopted them at an increasing speed and within adopting countries, they have spread over more sectors of the economy. Figure 4 provides a heat map to visualize this proliferation. Indeed, over this period, do-

[15] They note that "[...] policy adaptations to local contexts are attractive for political reasons. By following dominant norms, policymakers signal adherence to international best practice, while local adaptations allow them to either water down the effectiveness of a policy or even pursue goals that are not consistent with the original version of a policy. This way, policy makers can serve, at the same time, an international and domestic constituency."

mestic politics have similarly been heating up in many of the advanced democracies, with extremist and protest parties running on political platforms that have economic nationalism and de-globalization as core messages (figure 2). Interestingly, our results indicate that rather than resulting from such domestic political trends, ISM adoption is driven more by the erosion of the norm of a liberal world economic order at the level of international economic relations.

The next section presents our theoretical analysis of ISM adoption, based on risk reduction and political acceptability. The third section lays out our empirical approach, describes the data that we use, and presents preliminary results. The final section offers brief concluding remarks.

2 Theoretical mechanisms: risk reduction and political acceptability

Let us first consider a formal analysis of the home government's decision to implement an investment screening mechanism or not. We assume that although leading to growth in the home country, foreign investments entail security risks that can be mitigated by a screening mechanism. ISM can then be understood as a self-protection effort, in the sense of the risk and prevention literature (eg, Ehrlich and Becker 1972).

We analyze the incentives to screen in the simple setting of a binary risk. We then consider two possible outcomes for the domestic economy of an accepted FDI offer. Either the security risk isn't realized and FDI leads to some economic growth in the domestic economy, denoted by i, leading to a benefit denoted by g_i. Or the security risk is realized and the foreign firm causes damage to the domestic economy, denoted by $d_i < 0$. This damage can correspond for example to stealing the at-stake technology, and we assume that both benefits and damages can be sector specific (and denote by s the sector in which the investment takes place). For example, the potential damage from stolen nuclear submarine technology is far greater than that from stolen textile weaving technology but so is the potential added value from foreign investment. We finally denote by $p_i(c, s, \theta)$ the probability that a foreign firm from country c causes damage to the home country i after acquiring a share θ of one of its firms in sector s. This probability is likely to depend on both the regime and the laws of country c, as well as on the relationship between c and the host country i (i.e. for example on whether they are already in conflict or allies). It also depends on the extent of control the investor will acquire, that we model through the ownership share θ, with $\partial p_i(c,s,\theta)/\partial\theta > 0$.[16] As the size of the offer is also likely to positively impact the benefit of the investment, the expected payoff on an investment from country c, representing a share θ of a company in sector s is expressed as follows:

$$p_i(c,s,\theta)d(s) + (1 - p_i(c,s,\theta))g(s,\theta)$$

absent investment screening.

In face of this risk the home country can put an investment screening mechanism in place. The technology of screening then decreases the probability that an offer leads to damage. We denote by λ the intensity of screening and by $\phi(\lambda)$ the corresponding cost for the home country (assumed increasing and convex). The function $p_i(c,s,\theta,\lambda)$ then reflects the effect of screening, with $\partial p_i/\partial\lambda < 0$. Screening then corresponds to a self-protecting effort by decreasing the probability of damage, and to ease computations, we assume that its effect is multiplicative: $p_i(c,s,\theta,\lambda) = (1-\lambda)p_i(c,s,\theta)$. In other words, λ then measures the probability of damage avoidance (see Figure 3).[17] The expected payoff from screening at intensity λ an offer from country c for acquiring a share θ of a firm in sector s is then expressed as follows:

$$u_i(\lambda; c,s,\theta) = (1-\lambda)p_i(c,s,\theta)d(s) + (1-(1-\lambda)p_i(c,\theta,s))g(s,\theta) - \phi(\lambda).$$

We assume that a screening mechanism is politically costly (in terms of international relationships – both between governments and between business abroad and the domestic government – or domestic acceptance) and once introduced can vary in intensity (depending in particular on the foreign country but also the technology or the size of the investment). As described in the introduction, the home country's decision entails an initial stage in which a *de jure* mechanism is established for determining which incoming FDI offers will be subject to screening and another

[16]For a domestic firm with market capitalization of size Y, and an incoming FDI offer of size I, the ownership share is simply $\theta \equiv I/Y$

[17]One could alternatively assume that the role of screening is to block dangerous offers. In that case with probability λ, a potentially damaging offer (occurring with probability p_i) will be blocked and lead to no damage, nor gain. This would correspond to having $-\phi(\lambda)$ rather than $g(s,\theta) - \phi(\lambda)$ in the branch in the middle of the game tree. All our results remain under this alternative specification.

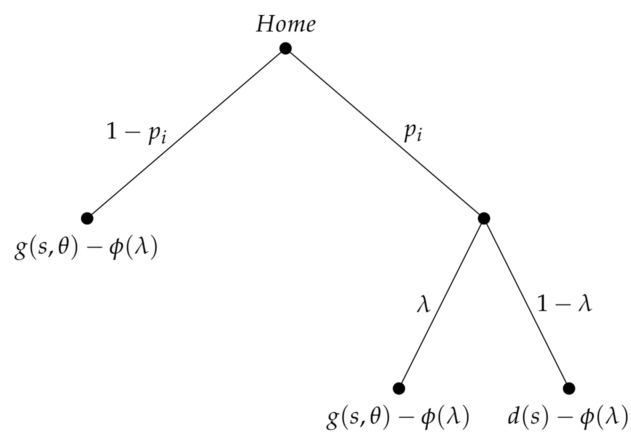

Figure 3: The effect of screening intensity on risk

stage in which FDI offers that qualify for screening are subjected to different *de facto* screening intensities. The *de jure* mechanism can vary across economic sectors, but cannot discriminate between origin countries. In contrast, the *de facto* screening intensity can discriminate between origin countries. A common feature of ISMs among OECD countries is that screenings get triggered when an FDI offer would result in an ownership share of the domestic company above a certain threshold (mostly decreasing over time). We model the *de jure* mechanism along these lines, and consider an ownership share threshold above which screenings are legally required (or possible).

We therefore model the ISM decision in a sector through a three-step procedure: **discuss the cost of each step**

1. For each sector, the home country has to decide whether or not to establish any Investment Screening Mechanism.

2. In the sectors for which an ISM is set, it then decides on a threshold of offers above which it can legally screen. These first two steps represents the *de jure* mechanism and cannot discriminate among sending countries.

3. For each offer above the threshold, the home country sets the screening intensity.

We proceed by backward induction with a focus on the first (de jure) stage, where political acceptance (that we will assume to depend on the ISM policies of other countries) is likely to be most stringent.

The *de facto* stage of screening. Once an investment screening mechanism is set and a threshold over offers (denoted $\overline{\theta}$) is fixed, at the third stage, the home country chooses the *de facto* intensity with which it screens incoming FDI offers for which $\theta > \bar{\theta}$. The optimal screening choice, by offer – that is by foreign country c and investment share θ – once an ISM in place in sector s solves:

$$\max_{\lambda} u_i(\lambda; c, s, \theta)$$

Then, the home country will chose different screening intensities based on perceived risks associated with the origin countries, and $\lambda_i^*(c,s,\theta)$ is the solution of:

$$p_i(c,s,\theta)[g(s,\theta) - d(s)] = \phi'(\lambda_i^*(c,s,\theta)). \tag{1}$$

For a given sector s FDI offers from countries that are perceived to pose a bigger risk of causing damage to the domestic economy (higher $p_i(c,s,\theta)$) are subjected to higher second stage screening since the cost function is increasing in screening intensity ($\phi'(\lambda) > 0$).[18]

The *de jure* stage of screening. Anticipating the *de facto* stage, the home country has to decide (a) over the opportunity to set an ISM in each sector s, and (b) over a threshold $\overline{\theta}$ in the considered sectors. We assume that setting a mechanism is costly for the domestic country. This cost, denoted ψ, can in particular reflect the political stigma (both domestically and internationally) stemming from not following the international norm and setting FDI restrictions. Once this stigma cost paid, the threshold for screening will determine the offers the home country will have to examine, that is the ones for which a screening intensity has to be chosen. We assume here this process entails a fixed administrative cost K for each offer above the threshold. The *de jure* mechanism being necessarily non-country specific, this cost has to be paid for all offers above the threshold, whatever the country of origin. The expected number of offers above $\overline{\theta}$ – denoted $N(\overline{\theta})$ – then equals $\sum_c (1 - F_c(\overline{\theta}))$ where $F_c(.)$ is the distribution of offers coming from country c.[19] The optimal threshold then trades off the total administrative cost from screen-

[18]If we assume that screening lead to blocking offers rather than to decreasing the probability of damage (see footnote 17, equation (1) becomes: $-p_i(c,s,\theta)d(s) = \phi'(\lambda_i^*(c,s,\theta))$.

[19]For simplicity, we assume that the distributions of offers are independent from the threshold. In a more detailed

ing: $K \cdot N(\overline{\theta})$ with the security benefits from optimally screening the offers above the threshold: $\sum_c \left\{\mathbb{E}\left[u_i(\lambda^*, \theta, c, s) - u_i(0, \theta, c, s) \mid \theta \geq \overline{\theta}\right]\right\}$. Using the result of the third stage, the optimal threshold: $\overline{\theta_i}^*(s)$ is then the solution of:

$$\sum_c \left(\lambda_i^* \cdot \phi'(\lambda_i^*) - \phi(\lambda_i^*)\right) f_c(\overline{\theta_i}^*) = K \cdot n(\overline{\theta_i}^*) \tag{2}$$

with λ_i^* evaluated at $(c, s, \overline{\theta_i}^*)$, and $n(\theta)$ the density of offers of size θ $(n(\theta) = \sum_c f_c(\theta))$. This optimal choice reflects the country-blind nature of the threshold: whereas the benefits of screening depends on the sending country, the cost has to be paid on every offer above the threshold, whatever the country of origin.

In the first *de jure* stage, the decision for a country i to adopt an ISM in a given sector s then comes to compare its expected benefit – given the optimal threshold $\overline{\theta_i}^*(s)$ and the optimal intensities $\lambda_i^*(c, s, \theta)$ – to the costs of violating the norm, denoted $\psi_i(s)$. Given the above, the expected benefit from setting an ISM in sector s for country i is expressed as:

$$U_i^*(s) = \sum_c \left\{\mathbb{E}\left[u_i(\lambda_i^*; \theta, c, s) - u_i(0; \theta, c, s) - K \mid \theta \geq \overline{\theta_i}^*(s)\right]\right\} \tag{3}$$

and the decision of country i to set an ISM in sector s at time t:

$$x_i(s, t) = \mathbb{1}(U_i^*(s) \geq \psi_i(s, t)),$$

where we allow the cost to be time-dependent. Indeed, as explained above, a large part of this cost reflects political costs for setting a barrier to FDI and therefore depends on the past behavior of other countries.

More precisely, we will assume that the acceptance of ISM in a given sector increases with the number of countries who already adopted this kind of mechanism in this sector. Allowing country to asymmetrically influence one other, we end-up with a sector-time specific cost from adopting

model, it could be decreasing with the threshold (and increasing in the ISM set abroad) to reflect the reaction of sending countries.

an ISM, that can be written as:

$$\psi_i(s,t) = \Psi_i \cdot \left(1 - \sum_{j \neq i} \alpha_{ij} x_j(s,t-1)\right),$$

where $x_j(s,t-1) = \{0,1\}$ denotes an ISM is in place in country j in sector s the period before; and $\alpha_{i,j} \in [0,1]$ measures the influence of country j on country i.

The cost structure of the norm violation reflects that the political cost from setting an ISM in a sector decreases with the acceptability of such a policy; that itself increases when a country considered close (that is with a high α_{ij}) did so in the past. Acceptability may regard both international and national concerns. On the international side, it can correspond to (non tangible) cost in terms of influence or reputation; whereas nationally it may reflect the political costs or benefits of anti-globalization policies when citizens observe the policy choices of "close" countries.[20] Both of the costs appear lower when ISM emerges as a norm in surrounding (in terms of influence) countries.

The decision to screen a given sector then takes the form:

$$\sum_{j \neq i} \alpha_{i,j} x_j(s,t-1) > \frac{\Psi_i - U_i^*(s)}{\Psi_i} \tag{4}$$

and we can formulate the following theoretical predictions.

Theoretical predictions. *For intermediate levels of risk (that is of $U_i^*(s)$):*

1. *the likelihood of one country to adopt an ISM in a given sector is increasing in the number of adopters in that sector, and*
2. *the effect of adoption is higher when coming from more closely related country (i.e. a country with a higher α_{ij}).*

The prediction above stems from Jackson and Storms (2019), who show that when decision to adopt depends on friends' (or neighbors') adoption, the equilibrium behavior corresponds to a threshold strategy: ones adopts if enough of one's friends did.[21]

[20] One can easily include in the model a fixed political cost (or benefit) of setting an ISM, independently from other countries behavior, without altering the results.

[21] Neighborhood or friendship can here been understood as economic influence.

Remark. *Our theoretical predictions only hold for intermediate level of risk, that is intermediate levels of economic benefits from ISM $U_i^*(s)$, as:*

- *when $U_i^*(s)$ is high ($U_i^*(s) > \Psi_i$), country i always adopts an ISM in sector s, whatever the behavior of other countries (this could for example correspond to the case of defense production), and*
- *when $U_i^*(s)$ is low ($U_i^*(s) < \Psi_i \cdot (1 - \sum \alpha_{ij})$), country i never adopts ISM in sector s, whatever the behavior of other countries (e.g., a country has no risk of damage because there are no companies and thus no offers in this sector).*

The above mechanism relying on a level of acceptance of screening increasing in the number of other countries imposing sectoral screening, could then explain the rise in ISM highlighted above. Indeed, as highlighted in Jackson and Storms (2019) or Watts (2011), this kind of network model of adoption can easily trigger cascading effects. We develop below an empirical strategy aiming at confirming the existence of peer effects on ISM adoption.[22]

3 Empirical approach, data and preliminary results

In this section, we empirically test the two predictions that result from the theoretical model. Does the screening in other countries influence a country's decision to screen a sector? Does the strength of the network link matter? Put differently, we want to analyze the influence of peers on a country's own behavior. This means we operate in a network where each country influences all other countries and the other way around.

3.1 Empirical approach

We analyze the sectoral adoption of an ISM using a linear probability model. Our parsimonious baseline model is at the country-sector-year level and estimated using Ordinary Least Squares

[22] These peer effects could potentially come from other theoretical mechanisms, as for example information diffusion. However, the relevant information for ISM (regarding risk of damage) being country specific, the mechanism through which the adoption of one country could inform another on its own risk, would entail an important degree of correlation between each country risk.

(OLS):

$$ISM\,adoption_{ist} = \beta\,Norm_{ist-1} + \gamma\,Own\,screening\,experience_{ist-1} + \xi X_i t + \gamma_t + \delta_s + \rho_i + \epsilon_{ist}, \quad (5)$$

where i refers to the country, s to the sector, and t to the year. We define the dependent variable as 0 before adoption, 1 in the year of adoption and missing afterwards. Our interest lies in β, the effect of the international norm on domestic sector-specific screening adoption. A significant coefficient β indicates the international norm ψ explain ISM implementations. We control for a country's previous screening experience in other sectors $r \neq s$.[23] and, as parsimonious baseline controls X_{it}, we add the one-year lag of logged GDP p.c. to analyze whether richer populations are more likely to adopt an ISM (e.g., because they can either afford the consequences of adopting an ISM or have a higher probability or size of damage), and the one year-lag of logged GDP to capture whether the size of a country correlates with adoption (e.g., because it influences a country's possibility to be less sensitive to other countries' response such as retaliation). The inclusion of year-fixed effects absorbs common shocks such as the COVID-19 outbreak or newly gained awareness about a sector being risky after an (attempted) acquisition in other sectors. Sector-fixed effects account for differential trends in the riskiness of sectors for security and public order. For example, sensitive data has become an issue only over the last decade or biotechnology over the pandemic years while the production of military equipment or risks associated with the ownership of water infrastructure have not experienced such a radical change in perceived riskiness. Finally, the inclusion of country-fixed effects account for time-invariant differences about (FDI) regulation and economic openness, the geographic location, or the size of countries. Robust standard errors are clustered at the country level. In robustness analyses, we include country-year fixed effects to absorb time-variant country-specific events such as election years. These high-dimensional effects have the disadvantage that they absorb some of the variation of interest when norms in multiple sectors change.

[23] We construct $Own\,screening\,experience_{ist-1} = \sum_{r \neq s} ISM_{jrt-1} / \sum_r \mathbb{1}_r$

3.2 Measuring bilateral influence

We test the prediction about the influence of other countries' sectoral ISM adoption on the adoption probability of the domestic economy using equal weights for all countries in the sample. All countries are linked to all countries so that we have a full network. Formally, we define foreign influence as:

$$Norm_{ist-1} = \sum_{j \neq i} \alpha_{i,j} * ISM_{jst-1}$$

with weight

$$\alpha_{i,j} = \frac{1}{\sum_j \mathbb{1}_j}$$

where i refers to the domestic country, j to the partner country, s to the sector, and t to the year.

The second prediction of the model is that there is a stronger influence on the adoption of sectoral screening for "close" countries. Closeness might refer to economic, political or geographic closeness. For example, a country might consider the norm held in countries that have politically aligned preferences as this affects the credibility in this network. Alternatively, countries might influenced by the international norm of economically close countries because this affects the reputation costs with these economic partners. Empirically, we compare the weights based on country's bilateral trade network to other networks. The links between countries are bi-directional, i.e., the trade weight of a large country A for a smaller country B may be much larger that the trade weight of country B for country A.

As the international norm about investment screening is in the economic realm, our main measure of bilateral importance uses trade data for which data is of high quality. Alternatively, we construct measures of bilateral influence that proxy international political alignment, geographic proximity or other economic linkages. The variable for a partner country's bilateral influence on the domestic country is non-zero if there is sector-specific screening in the partner country. Formally, we define foreign trade influence as:

$$\alpha_{i,j} = \frac{trade_{ij}}{\sum_{j \neq i} trade_{ij}}$$

where $trade_{ij}$ to a country's bilateral trade in 2006, i.e., the pre-sample period (UNCTAD, 2021). In future versions of the paper, we will use sector-specific bilateral trade relationships by combining sector-specific trade data with the screened sectors.

To measure political proximity, we propose weights based on the distance between the two countries' ideal points in the United Nations General Assembly (UNGA) (Bailey, Strezhnev and Voeten, 2017). We construct the distance-weights as follows

$$\alpha_{i,j} = \frac{1}{distance_{ij}} * \frac{1}{\sum_{j \neq i} distance_{ij}}$$

UNGA and trade proximity weights are negatively correlated in our regression sample (-0.018). In additional robustness analysis, we also check how geographic distance affects adoption (in addition to economic and political influences). Geographic weights (Head and Mayer, 2014) are constructed analogously to UNGA voting weights. Note that the distance weights are unidirectional.

3.3 Data

Data on investment screening mechanisms for OECD countries is provided by Bauerle Danzman and Meunier (2021) and is currently being finalized. This might result in minor data revisions and results. We extend their country coverage to include the four EU countries that are not also OECD members. The data covers the years 2007-2021. The coding of national screening regulations results in a categorization of screening in 36 distinct 'sectors.' A sector is included in the sample if at least one government screens FDI in this sector. The government thus considers the sector as holding risks for national security and public order. Figure 4 shows the evolution of protected sectors with color codes. The vertical axis ranks sectors by the number of countries screening the sector in 2007 while the horizontal axis lists countries by the number of sectors they screened in 2007. Some sectors like defense production or telecommunication infrastructure have been screened in many countries for many years while new sectors like robotics or artificial intelligence have been considered as critical sectors only recently and in a few countries. Figure 5 shows the

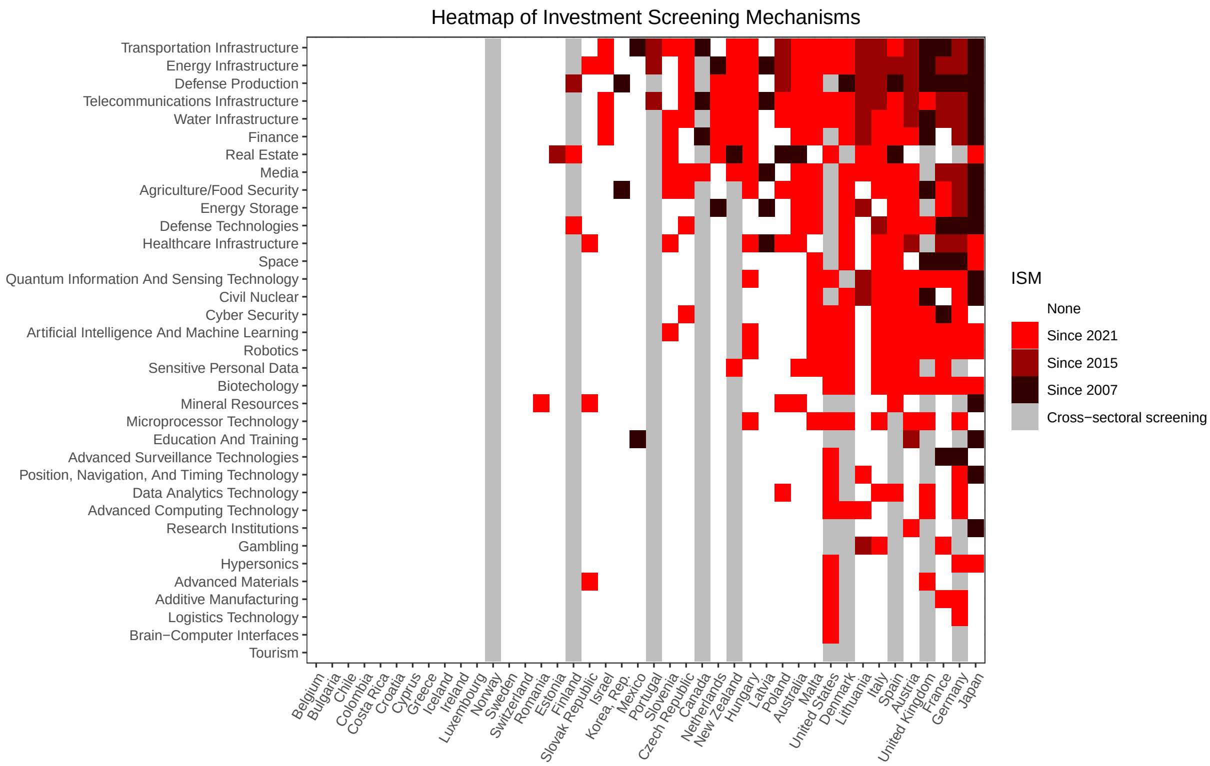

Figure 4: Screened sectors in selected OECD countries. Reversals are coded for countries screening a sector in 2020 but not in any one of the following years: 2017, 2014, 2010, and 2007. Grey shaded columns refer to countries with a cross-sectoral mechanism or with both a cross-sectoral and sectoral screening approach. Source: Data from Bauerle Danzman and Meunier (2021), own representation.

cumulative adoption of sectors as in a survival model. This means that sectors already screening in 2007, the beginning of the sample period, are not taken into account. The figure shows that the evolution of the adoption has a cascading character rather than proceeding linearly. This provides some first evidence that is not a (pure) learning process where new information about risk becomes available to all countries at the same point in time. In a diffusion process due to learning, all countries would react more or less simultaneously to this new information about sector-specific risk. The information diffusion process would need to be very slow to be consistent with our results. Figure 8 – Figure 6 show the cumulative adoption of sectoral screening for all countries that screen at least one sector. Table 1 shows summary statistics for our variables of interest.

	Observations				
	count	mean	sd	min	max
ISM adoption	20091	0.01	0.11	0.00	1.00
Domestic screening	20091	0.01	0.11	0.00	1.00
N of sectors screened domestically	20091	1.88	3.78	0.00	26.00
Share, other domestic sectors, t-1	20091	0.04	0.08	0.00	0.72
Domestic cross-sectoral screening, t-1	20091	0.16	0.37	0.00	1.00
Sectoral screening abroad, trade weight, t-1	20091	0.10	0.17	0.00	0.94
Cross-sectoral screening abroad, trade weight, t-1	20091	0.37	0.17	0.05	0.87
Share other sectors screened abroad, trade weight, t-1	20091	0.97	0.04	0.79	1.00
EU framework	20091	0.13	0.34	0.00	1.00
EU framework by sectors	20091	0.59	0.49	0.00	1.00
Sectoral screening abroad (incl. cross), trade weight, t-1	20091	0.43	0.19	0.05	0.96
Sectoral screening abroad, equal weight, t-1	20091	0.05	0.07	0.00	0.46
Sectoral screening abroad, (equal - trade) weight, t-1	20091	-0.05	0.11	-0.78	0.25
Sectoral screening abroad, UNGA weight, 2006	20091	0.04	0.10	0.00	0.99
Sectoral screening in EU, trade weight, t-1	13280	0.10	0.16	0.00	0.79
Sectoral screening in non-EU, trade weight, t-1	13280	0.01	0.02	0.00	0.24
Sectoral screening abroad, FDI weight, 2006	20091	0.11	0.34	-1.88	3.87
Sectoral screening abroad, Migration weight, 2000	20091	0.09	0.17	0.00	0.99
Protectionism, negative mention	4310	0.09	0.24	0.00	1.90
Protectionism, positive mention	4310	0.39	0.84	0.00	6.95
Nationalist ideology	20091	0.49	0.27	0.00	1.00
Socialist ideology	20091	0.21	0.25	0.00	1.00
Sectoral screening abroad, trade weight, ISM, top 10	20091	0.09	0.16	0.00	0.92
Sectoral screening abroad, trade weight, ISM, top 5	20091	0.08	0.14	0.00	0.90
Top 10 GDP partners, ISM, trade weight	20091	0.09	0.15	0.00	0.93
Top 5 GDP partners, ISM, trade weight	20091	0.07	0.13	0.00	0.89
Observations	20091				

Table 1: Summary statistics of regression sample. OECD + non-OECD EU members, 2007-2021.

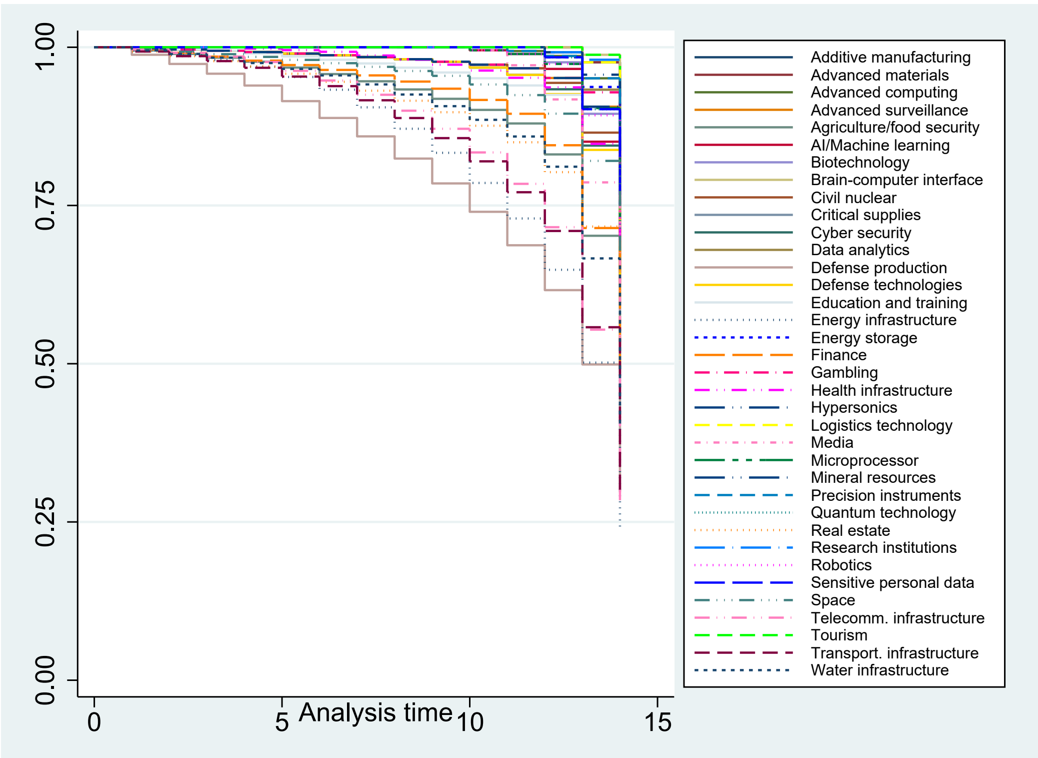

Figure 5: Cumulative adoption of screening by sectors. Note: Kaplan-Meier estimates.

3.4 Preliminary results

We find robust evidence that the adoption of an ISM in a given sector correlates with other countries screening of the same sector in the past year but not with other countries' screening of other sectors. We present our baseline results in Table 2. Column 1 shows that an increase of one standard deviation in screening abroad increases the likelihood to adopt by seven percent. Column 2 shows the robustness of this correlational evidence to the inclusion of country-year fixed effects. Importantly, the estimated coefficient of interest remains of similar magnitude. This suggests that there are no important omitted variables at the country-year level which affect the relationship between the international sector norm and adoption. A country's likelihood to adopt screening in additional sectors descreases with the share of sectors the country already screens domestically (last variable in the regression Table 2.[24] We are also interested in whether there truly exists a sector-specific norm or whether there is a general norm about screening. We test for this possibility in column 3 by adding the share of other sectors screened abroad, again weighted by trade. The coefficient on the sectoral screening norm remains statistically significant and increases in size while the coefficient on the general screening norm is positive but clearly insignificant. This suggests that there exists a strong sector-specific rather than a general sector-independent norm about screening. One important generalization we have made regarding investment screening is that all countries have taken a sectoral perspective when screening foreign investments for security risks. In reality, we can define three types of screening approaches, all of which apply to some threshold of control. A first set of countries screens sector by sector (sectoral approach). A second set of countries explicitly mentions some sectors which are always screened and in addition have the legal competence to screen all sectors (at least for some types of investors) (mixed approach). In a third set of countries, authorities can screen all foreign investments, independent of the sector (cross-sectoral approach). We adopt two approaches to measure whether there exists a norm about cross-sectoral screening. First, we consider whether there is a cross-sectoral screening norm separate from the norm about sectoral screening. We construct the norm by multiplying the trade

[24] If we replace the share of sectors screened domestically by an indicator variable that is one if the country screened any sector in the previous year, we obtain a statistically insignificant negative effect which turns highly significant when we account for country-year fixed effects.

	(1)	(2)	(3)
Sectoral screening abroad, trade weight, t-1	0.071**	0.065***	0.080**
	(0.032)	(0.025)	(0.035)
Share other sectors screened abroad, trade weight, t-1			0.212
			(0.159)
Share, other domestic sectors, t-1	-0.095*	-0.986***	-0.092
	(0.057)	(0.004)	(0.057)
Country FE	✓	✓	✓
Year FE	✓	✓	✓
Sector FE	✓	✓	✓
Country-year FE		✓	
Controls	✓	✓	✓
Observations	20091	20091	20091
$R^2 overall$	0.08	0.34	0.08

Table 2: Main estimation results with trade as measure of network strength. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is set to missing thereafter. Full specification in Table 11. Robust standard errors are clustered at the country level.

weights with an indicator that is one for countries that have a cross-sectoral ISM in a given year. We add this indicator and the one-year lag of an indicator for domestic cross-sectoral screening to our baseline specification. Column 4 in Table 2 suggests that the norm about cross-sectoral screening has no significant effect on the home country's screening decision. Second, we consider the possibility that other countries evaluate a cross-sectoral screening approach as screening in investments in all sectors. We thus re-define our variable of interest, sectoral screening abroad. Specifically, we re-define the indicator variable which is multiplied by the trade weight to be one for all sectors in country-years with cross-sectoral screening. According to column 5 in Table 2, a sectoral norm modified in this way increases the likelihood of adoption. The coefficient is statistically significant only at the ten percent level but of larger magnitude than in the baseline definition of the sectoral screening norm.

We argued above that, besides the relative economic importance, the strength and quality of a bilateral relationship might depend on political and geographic proximity. In Table 3, we formally test alternative types of network weights. After reproducing the baseline specification with trade weights, column 2 shows that a sectoral norm using equal weights has a large explanatory power.

Column 3 runs a horse-race between the trade and the equal weight by adding the difference between the equal weight and the trade weight. The coefficient on the difference is statistically insignificant but the negative sign provides evidence that the influence diminishes as countries are less important trading partners. In future versions of the manuscript, we want to scrutinize this result in more detail to disentangle whether the strength of economic links affect the adoption likelihood. Specifically, we will estimate the network of influence in ISM adoption (using BIC or Lasso) and test whether a trade or other existing network can explain it.

Column 4 in Table 3 tests for political proximity. The distance in preferences about international politics constructed based on votes in the UNGA in 2006 has a statistically insignificant but positive correlation coefficient, indicating that links based on international political relations do not heavily influence ISM adoption. Column 5 provides evidence that the structure of a country's FDI inflow network is associated positively ISM adoption, though we note that the bilateral FDI data is far from perfect, so we take this result with a healthy grain of salt. Column 6 weights network links by bilateral migration flows and shows an insignificant effect. Finally, column 7 tests for a geography-based norm about screening by using weights based on geographical distance. Given that geographic distance is a key determinants of trade in gravity models of trade, we are not surprised that we find that a distance-weighted sectoral norm correlates positively with ISM adoption. Moreover, geographic distance might also proxy for economic relationships than trade. We will investigate this issue in more detail in future versions of the paper.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Sectoral screening abroad, trade weight, t-1	0.071**						
	(0.032)						
Sectoral screening abroad, equal weight, t-1		0.191**	0.177**				
		(0.088)	(0.087)				
Sectoral screening abroad, (equal - trade) weight, t-1			-0.052				
			(0.036)				
Sectoral screening abroad, UNGA weight, 2006				0.048			
				(0.029)			
Sectoral screening abroad, FDI weight, 2006					0.019***		
					(0.005)		
Sectoral screening abroad, Migration weight, 2000						0.004	
						(0.013)	
Share sectors screened abroad, distance weight, t-1							0.097*
							(0.053)
Share, other domestic sectors, t-1	-0.095*	-0.093*	-0.089	-0.103*	-0.107*	-0.106*	-0.097*
	(0.057)	(0.056)	(0.056)	(0.056)	(0.056)	(0.057)	(0.057)
Country FE	✓	✓	✓	✓	✓	✓	✓
Year FE	✓	✓	✓	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓	✓	✓	✓
Controls	✓	✓	✓	✓	✓	✓	✓
Observations	20091	20091	20091	20091	20091	20091	20091
$R^2 overall$	0.08	0.08	0.08	0.08	0.08	0.08	0.08

Table 3: Political and alternative economic measures of bilateral network strength. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. Robust standard errors are clustered at the country level.

	(1)	(2)	(3)	(4)	(5)	(6)
Sectoral screening abroad, trade weight, t-1	0.117**		0.117**	0.072**	0.116**	0.070**
	(0.051)		(0.051)	(0.032)	(0.051)	(0.032)
Sectoral screening in EU, trade weight, t-1		0.111**				
		(0.050)				
Sectoral screening in non-EU, trade weight, t-1		0.364				
		(0.386)				
EU framework, t-1			0.022	0.033		
			(0.029)	(0.038)		
EU framework by sectors, t-1					0.023	0.033
					(0.020)	(0.022)
Share, other domestic sectors, t-1	-0.093	-0.094	-0.093	-0.101*	-0.092	-0.095*
	(0.068)	(0.069)	(0.068)	(0.055)	(0.068)	(0.056)
Country FE	✓	✓	✓	✓	✓	✓
Year FE	✓	✓	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓	✓	✓
Controls	✓	✓	✓	✓	✓	✓
Notes	EU	EU	EU	Full sample	EU	Full sample
Observations	13280.00	13280.00	13280.00	20091.00	13280.00	20091.00
$R^2 overall$	0.09	0.09	0.09	0.08	0.09	0.08

Table 4: Analysis of the norm and the screening framework in the European Union. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. The EU framework indicator in columns 3 and 4 is one for all EU member states (with or without ISM) in 2019 and the years thereafter. In columns 5 and 6, the EU framework variable is one in 2019 and thereafter in EU countries and sectors listed in the EU framework (Union, 2019). Robust standard errors are clustered at the country level.

Our theoretical model predicts that the strength of networks influences the probability to adopt screening. One particular strong network is the European Union with multidimensional links across countries and strong political and economic interdependence. We empirically gauge these relationships by constructing a EU-specific norm based on sectoral ISM adoption in EU countries and a non-EU norm based on sectoral ISM adoption in the non-EU countries as described above. Column 1 in Table 4 shows that our previous result about the relevance of the international sectoral norm is economically and statistically robust when reducing the sample to EU countries. The influence of the norm derives from other EU countries' behaviors rather than OECD countries elsewhere in the world (column 2). Columns 3 and 4 show, respectively for the sample of EU countries and the full sample, that this result is not driven by the joint EU framework on investment screening that entered into force in spring 2019.[25] The EU screening framework does not require member states to screening foreign investments but defines criteria for ISMs for those

[25] The joint EU framework regulation on investment screening fully applied from October 2020.

	(1)	(2)	(3)	(4)
Top 5 trading partners, ISM and equal weight	0.474*			
	(0.246)			
Other than 5 trading partners, ISM and equal weight	0.127			
	(0.099)			
Top 10 trading partners, ISM and equal weight		0.226		
		(0.145)		
Other than 10 top trading partners, ISM and equal weight		0.168		
		(0.129)		
Top 5 economic powers, ISM and equal weight			0.822***	
			(0.302)	
Other than 5 trading partners, ISM and equal weight			0.060	
			(0.107)	
Top 10 economic powers, ISM and equal weight				0.275
				(0.178)
Other than 10 top trading partners, ISM and equal weight				0.140
				(0.124)
Share, other domestic sectors, t-1	-0.095*	-0.093*	-0.098*	-0.093*
	(0.056)	(0.056)	(0.056)	(0.056)
Country FE	✓	✓	✓	✓
Year FE	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓
Controls	✓	✓	✓	✓
Observations	20091	20091	20091	20091
$R^2 overall$	0.08	0.08	0.08	0.08

Table 5: Top partners. Regression results with fixed effects. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. Robust standard errors are clustered at the country level.

countries choosing to adopt an ISM. Empirically, we capture this by adding an indicator variable that is one for all EU member states (with or without ISM) in 2019 and the years thereafter. We find a significant effect only for the EU sample countries (column 3) although the coefficient remains positive in the full sample in column 4. This means that there is only limited evidence for an EU specific effect once we account for the strength of the network. In the last two columns, we refine the EU framework variable by making it sector-specific. The indicator variable is one in 2019 and thereafter in EU countries and sectors listed in the EU framework (Union, 2019). Again, the coefficient of interest about impact of sectoral screening abroad is robustly statistically and economically significant. The coefficient on the EU framework is again positive but does not reach conventional levels of statistical significant.

Our goal is to estimate the network of ISM influence and to explain it by existing observable networks like trade. A first step in this direction is the analysis of bilateral relationships of in-

	(1)	(2)	(3)	(4)	(5)	(6)
DEU ISM influence, t-1	0.015***	0.015***	0.013**	0.016***	0.015***	0.013**
	(0.004)	(0.005)	(0.005)	(0.004)	(0.005)	(0.005)
FRA ISM influence, t-1	0.010***	0.013**	0.006	0.011***	0.013***	0.006
	(0.003)	(0.005)	(0.004)	(0.003)	(0.005)	(0.004)
GBR ISM influence, t-1	0.013***	0.012**	0.012**	0.013***	0.012**	0.013**
	(0.003)	(0.004)	(0.005)	(0.003)	(0.005)	(0.005)
JPN ISM influence, t-1	0.015***	0.014***	0.012**	0.015***	0.014***	0.013**
	(0.003)	(0.005)	(0.004)	(0.003)	(0.005)	(0.004)
USA ISM influence, t-1	0.008*	0.010	0.003	0.009*	0.011*	0.004
	(0.004)	(0.006)	(0.003)	(0.004)	(0.006)	(0.003)
Other EU countries' ISM influence, t-1				0.015***	0.015**	0.014**
				(0.004)	(0.006)	(0.006)
Sample	all	EU	non-EU	all	EU	non-EU
Partner-FE(LHS country)	no	no	no	no	no	no
Reporter-FE(RHS country)	yes	yes	yes	yes	yes	yes
Year-FE	yes	yes	yes	yes	yes	yes
Sector-FE	yes	yes	yes	yes	yes	yes
Cluster level	Partner country	Partner country	Partner country	Partner country	Partner country	Partner country
Observations	823731	544480	279251	823731	544480	279251
$R^2 adjusted$	0.05	0.05	0.07	0.05	0.05	0.07

Table 6: Dyadic regression and the top five economic powers and the other EU countries (excl. France, Germany and the United Kingdom). OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. Robust standard errors are clustered at the country level.

fluence focusing on the 'closest' countries among the 41 partner countries. We start by focusing on the biggest trade partners of countries. We construct a variable measures the influence of ISM adoption in five (ten) the largest trading partners and the influence of ISM adoption in the five (ten) largest economies.[26] Table 5 shows that ISM adoption is significantly more influenced by the largest five countries or trading partners than by the non-top five countries on ISM adoption (columns 1 and 3). In contrast, there is no significantly higher influence of the top 10 countries on ISM adoption than of the remaining 31 countries (columns 2 and 4). These results suggest that there are a few very influential countries in the network that influence adoption in other countries.

We then proceed to analyze the influence of the largest economic powers in a dyadic network at the sectoral level. We construct an indicator variable for each of five largest partner economies plus the EU which is one in sector-years in which the large economy has a sector-specific ISM. For example, the "USA ISM influence, t-1" measures whether the sector-specific ISM adoption of the partner country is explained by screening of this sector by the United States. Table 6 shows that sectoral screening in any of the major economies influences the probability of adoption in other countries by eight to fifteen percent (incl. in other large countries). The coefficient on the

[26]The two measures for top five countries correlate with $R = 0.9449$.

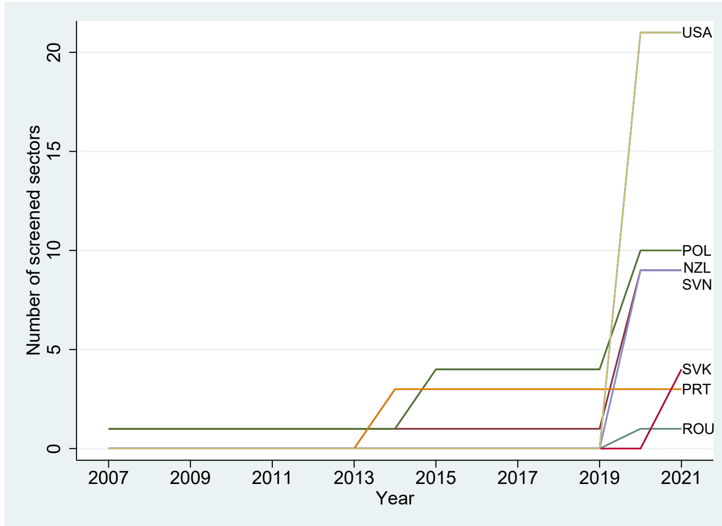

Figure 6: Cumulative adoption of new sectors that are screened for a subset of countries.

USA influence variable is is barely statistically significant in column 1 and turns insignificant in columns 2 and 3 that limit the set of countries to EU countries (incl. the United Kingdom) and non-EU countries (i.e., the sample is defined by the left hand side country but its dyadic relationship with both EU countries and non-EU countries remains in the sample). This finding seems to go against anecdotal evidence that the United States promoted the idea of investment screening among its Western partner states. Note however that we control for year-fixed effects which already account for the effect of US activities of influence.

We then proceed to adding the set of other EU countries as a joint actor in columns 4–6 for different samples. Note that the influence of other EU countries excludes the influence of Germany, France and the United Kingdom for which we estimate the influence separately. Again, we find that sectoral adoption by any of the major actors influences the adoption in other countries. Interestingly, France and the United States do not seem to have an influence on non-EU countries. This will require more research. Figure 6 shows that the United States has adopted many additional sectors recently and at the same time. The United States now screens more sectors than many other countries.

The correlational evidence so far leads us to conclude that there is a sector-specific norm about screening. However, we cannot yet empirically distinguish our hypothesis from competing sto-

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Sectoral screening abroad, trade weight, t-1	0.071**	0.079**	0.071**	0.071**	0.072**	0.072**	0.071**
	(0.032)	(0.040)	(0.032)	(0.032)	(0.032)	(0.032)	(0.032)
Inward FDI stock, 2015 constant USD, ln, t-1	-0.001						
	(0.002)						
Inward FDI stock (as share of GDP)		-0.000					
		(0.000)					
Outward FDI stock, ln, t-1			-0.001				
			(0.002)				
Election year (t-1)				-0.003			
				(0.004)			
Nationalist ideology, t-1					-0.019		
					(0.038)		
Socialist ideology, t-1					-0.004		
					(0.017)		
Protectionism, positive mention, extended, t-1						0.006	
						(0.004)	
Protectionism, negative mention, extended t-1							-0.023
							(0.017)
Share, other domestic sectors, t-1	-0.094	-0.058	-0.094	-0.095*	-0.094*	-0.098*	-0.098*
	(0.058)	(0.116)	(0.058)	(0.057)	(0.056)	(0.057)	(0.058)
Country FE	✓	✓	✓	✓	✓	✓	✓
Year FE	✓	✓	✓	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓	✓	✓	✓
Controls	✓	✓	✓	✓	✓	✓	✓
Observations	20091	17292	20091	20091	20091	20091	20091
$R^2 overall$	0.08	0.08	0.08	0.08	0.08	0.08	0.08

Table 7: Regression results with trade-weight. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. Robust standard errors are clustered at the country level.

ries, namely the diffusion of information about sector-specific risk. While there is some anecdotal evidence for our explanation, we plan to use cross-country and temporal variation in sectoral thresholds applied to define transactions that are to be screened from transactions that do not need to be screened.

For this version of the paper, we conclude with two tables that analyze the domestic political economy of the adoption of sectoral investment screening. Table 7 presents results using our baseline trade-weighted sectoral link for estimating the effect of the norm. In various specifications, we include controls for the log of inward FDI stock, the log of outward FDI stock, inward FDI shock as a share of GDP, for election year, and a measure of socialist / communistic ideology. New results with the mentioning of protectionism in positive and negative ways in party manifestos provide further evidence that the domestic political economy is of limited importance (Walter, 2021). Throughout these regressions, the coefficient of interest (on sectoral screening abroad) barely changes when we add these variables that analyze the domestic political variables that favor the adoption of an ISM, indicating that diffusion effects impact ISM adoption on top of domestic political issues.

4 Concluding remarks

This manuscript is very much work in progress. We draw preliminary evidence on the diffusion of a norm regarding ISM adoption, driven by the adoption from trading partners and economic leaders. Our next steps involve better dealing with competing explanations (by controlling for risk exposure, eg. using R&D data; and by analyzing the effect of changes in ISM threshold) and trying to infer more precisely the network governing diffusion.

The proliferation of ISMs raises several concerns for economists and social scientists more broadly. We highlight three here. First, ISMs are deliberate frictions in the international allocation of capital, which may be potentially distorting, reducing global economic growth. On the supply side, there is the direct effect of limiting foreign acquisition, but more importantly a deterrent effect on future bidding by foreign companies for other companies in the domestic country, making foreign acquisitions less likely (Eichenauer and Wang, 2021). On the demand side, screening may lower competition in the acquisition market, depressing transactions and lowering valuations (Connell and Huang 2014; Pohl and Rosselot 2020; Eichenauer, Dorsch and Wang 2021). [27] The second concern is that ISMs could potentially be co-opted for reasons of protectionist rent-seeking, generally considered to be a more pernicious form of inefficiency (Djankov et al., 2002; Congleton, Hillman and Konrad, 2008). While we do not analyze explicitly the possibility that ISMs may be a new form of protectionism, there is some recent literature on the use of regulation to protect do-

[27] Pohl and Rosselot (2020) report anecdotal evidence of a drop in actual prices for the Australian electricity grid after the government announced tighter screening and in some transactions in the technology sector as the alternative buyer offered a lower acquisition price than foreign buyers. Connell and Huang (2014) estimate a 2.097% or higher industry-wide shock from a CFIUS merger denial. This would imply that the real effect per defense-related CFIUS block is a $2.44 billion single-day transfer to the U.S. defense industry. Eichenauer and Wang (2021) use deal level data on sectoral mergers and acquisitions (M&A) to analyze the causal impact of investment screening mechanisms on the number of transactions, the origin of investors, and the valuation price.

mestic industries in the neoliberal era (Owen, 2013; Danzman, 2020; Gründler and Hillman, 2021). Indeed, there is evidence that commercial interests may shape politicians' support for investment screening (Graham, Marchick et al., 2006; Canes-Wrone, Mattioli and Meunier, 2020) and that governments use foreign investment screening for improving domestic economic capacity in addition to addressing security concerns (Lenihan, 2018; Zimmerman, 2019), suggesting ISMs have real economic impacts that could be the source of rent-seeking behavior. And, finally, the proliferation of ISMs feeds into the mega-trend of de-globalization in politics and economics (Walter, 2021). Adoption of ISMs is both driven by the erosion of the norm of a liberal world economic order and a contributor to it.

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5 Further tables and results

	(1)	(2)	(3)	(4)	(5)
Sectoral screening abroad, trade weight, t-1	0.071**	0.065***	0.080**	0.071**	
	(0.032)	(0.025)	(0.035)	(0.032)	
Share other sectors screened abroad, trade weight, t-1			0.212		
			(0.159)		
Domestic cross-sectoral screening, t-1				-0.003	
				(0.014)	
Cross-sectoral screening abroad, trade weight, t-1				0.060	
				(0.046)	
Sectoral screening abroad (incl. cross), trade weight, t-1					0.091*
					(0.048)
Share, other domestic sectors, t-1	-0.095*	-0.986***	-0.092	-0.099*	-0.108*
	(0.057)	(0.004)	(0.057)	(0.058)	(0.058)
GDP, ln, t-1	0.027		0.028	0.035	0.045
	(0.112)		(0.112)	(0.113)	(0.116)
GDP p.c., ln, t-1	-0.051		-0.052	-0.054	-0.066
	(0.104)		(0.104)	(0.104)	(0.106)
Country FE	✓	✓	✓	✓	✓
Year FE	✓	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓	✓
Country-year FE		✓			
Observations	20091	20091	20091	20091	20091
$R^2 overall$	0.08	0.34	0.08	0.08	0.08

Table 8: Full specification including covariates as shown in Table 2. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is set to missing thereafter. Robust standard errors are clustered at the country level.

	(1)	(2)
(sum) lasso_weight_d_ism1	0.007	0.007
	(0.007)	(0.007)
Share, other domestic sectors, t-1	-0.108*	-0.110*
	(0.058)	(0.057)
Country FE	✓	✓
Year FE	✓	✓
Sector FE	✓	✓
Controls		✓
Observations	20091	20091
$R^2 overall$	0.08	0.08

Table 9: Regression using dummy weights extracted from adaptive lasso regressions. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is set to missing thereafter. Robust standard errors are clustered at the country level.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Sectoral screening abroad, trade weight, t-1	-0.064			0.281	-0.072	-0.078			0.270	-0.087
	(0.352)			(0.220)	(0.204)	(0.398)			(0.241)	(0.232)
Sectoral screening abroad, equal weight, t-1	5.648***	4.515***	3.923*			5.541***	4.434***	3.884*		
	(1.660)	(1.199)	(2.225)			(1.577)	(1.236)	(2.265)		
Share sectors screened abroad, distance weight, t-1	-0.922	-1.035	-0.825	-0.781	-0.927	-0.866	-0.965	-0.782	-0.733	-0.870
	(0.723)	(0.730)	(0.797)	(0.785)	(0.820)	(0.803)	(0.806)	(0.873)	(0.867)	(0.891)
Sectoral screening abroad, UNGA weight, t-1	-0.001	-0.001	-0.000	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Share sectors screened abroad, language weight, t-1	-0.332	-0.303	-0.091	-0.362	-0.332	-0.327	-0.303	-0.093	-0.355	-0.328
	(0.784)	(0.771)	(0.630)	(0.791)	(0.780)	(0.781)	(0.770)	(0.627)	(0.788)	(0.776)
Sectoral screening abroad, trade weight, ISM, top 5		-0.012					-0.026			
		(0.315)					(0.360)			
(sum) trade_weight_ism1_no5		2.509					2.477			
		(2.856)					(2.838)			
Sectoral screening abroad, trade weight, ISM, top 10			0.050					0.037		
			(0.234)					(0.267)		
(sum) trade_weight_ism1_no10			8.576					8.417		
			(13.222)					(13.032)		
Top 5 trading partners, ISM and equal weight				2.242					2.128	
				(2.462)					(2.540)	
Other than 5 trading partners, ISM and equal weight				5.722***					5.631***	
				(1.712)					(1.638)	
Top 10 trading partners, ISM and equal weight					5.717**					5.618**
					(2.499)					(2.601)
Other than 10 top trading partners, ISM and equal weight					5.628***					5.517***
					(1.949)					(1.840)
Country FE						✓	✓	✓	✓	✓
Year FE						✓	✓	✓	✓	✓
Sector FE						✓	✓	✓	✓	✓
Observations	22680	22680	22680	22680	22680	22680	22680	22680	22680	22680
R^2 *overall*	0	0	0	0	0	0	0	0	0	0

Table 10: Regression explaining the weights extracted from adaptive lasso regressions with other weights. Regressions at the country-sector-year level. Robust standard errors are clustered at the country level.

	(1)	(2)	(3)	(4)	(5)
Sectoral screening abroad, trade weight, t-1	0.071**	0.065***	0.080**	0.071**	
	(0.032)	(0.025)	(0.035)	(0.032)	
Share other sectors screened abroad, trade weight, t-1			0.212		
			(0.159)		
Domestic cross-sectoral screening, t-1				-0.003	
				(0.014)	
Cross-sectoral screening abroad, trade weight, t-1				0.060	
				(0.046)	
Sectoral screening abroad (incl. cross), trade weight, t-1					0.091*
					(0.048)
Share, other domestic sectors, t-1	-0.095*	-0.986***	-0.092	-0.099*	-0.108*
	(0.057)	(0.004)	(0.057)	(0.058)	(0.058)
GDP, ln, t-1	0.027		0.028	0.035	0.045
	(0.112)		(0.112)	(0.113)	(0.116)
GDP p.c., ln, t-1	-0.051		-0.052	-0.054	-0.066
	(0.104)		(0.104)	(0.104)	(0.106)
Country FE	✓	✓	✓	✓	✓
Year FE	✓	✓	✓	✓	✓
Sector FE	✓	✓	✓	✓	✓
Country-year FE		✓			
Observations	20091	20091	20091	20091	20091
$R^2 overall$	0.08	0.34	0.08	0.08	0.08

Table 11: Full specification including covariates as shown in Table 2. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is set to missing thereafter. Robust standard errors are clustered at the country level.

	(1)	(2)	(3)
Other EU countries' ISM influence, t-1	0.015***	0.015**	0.014**
	(0.004)	(0.006)	(0.006)
DEU ISM influence, t-1	0.016***	0.015***	0.013**
	(0.004)	(0.005)	(0.005)
FRA ISM influence, t-1	0.011***	0.013***	0.006
	(0.003)	(0.005)	(0.004)
GBR ISM influence, t-1	0.013***	0.012**	0.013**
	(0.003)	(0.005)	(0.005)
JPN ISM influence, t-1	0.015***	0.014***	0.013**
	(0.003)	(0.005)	(0.004)
USA ISM influence, t-1	0.009*	0.011*	0.004
	(0.004)	(0.006)	(0.003)
Sample	all	EU	non-EU
Country-FE(LHS)	no	no	no
Partner country-FE (RHS)	yes	yes	yes
Year-FE	yes	yes	yes
Sector-FE	yes	yes	yes
Observations	823731	544480	279251
$R^2 adjusted$	0	0	0

Table 12: Dyadic regression, top 5 economic powers, Italy not top 5. OECD + non-OECD EU members. The dependent variable covers the years 2008-2021 and turns one in the year of an adoption of sectoral screening and is missing thereafter. Robust standard errors are clustered at the country level.

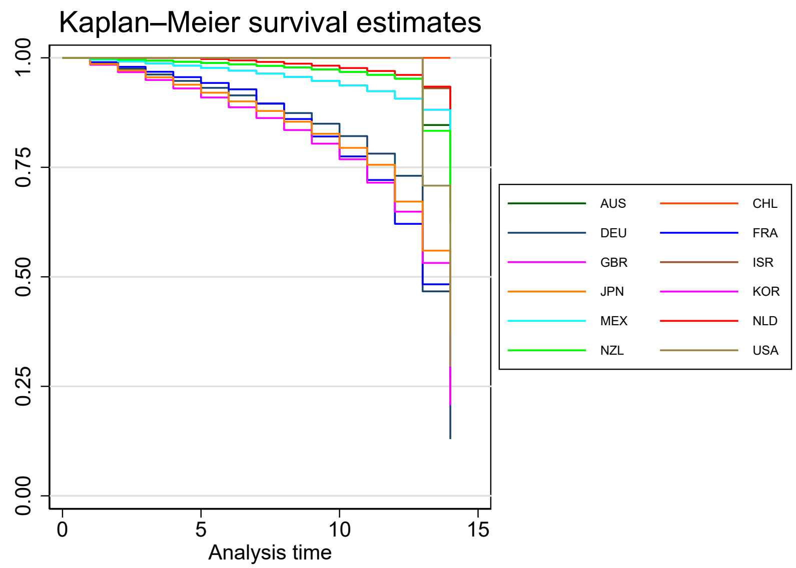

Figure 7: Cumulative adoption of new sectors that are screened for a subset of countries. Note: Kaplan-Meier estimates.

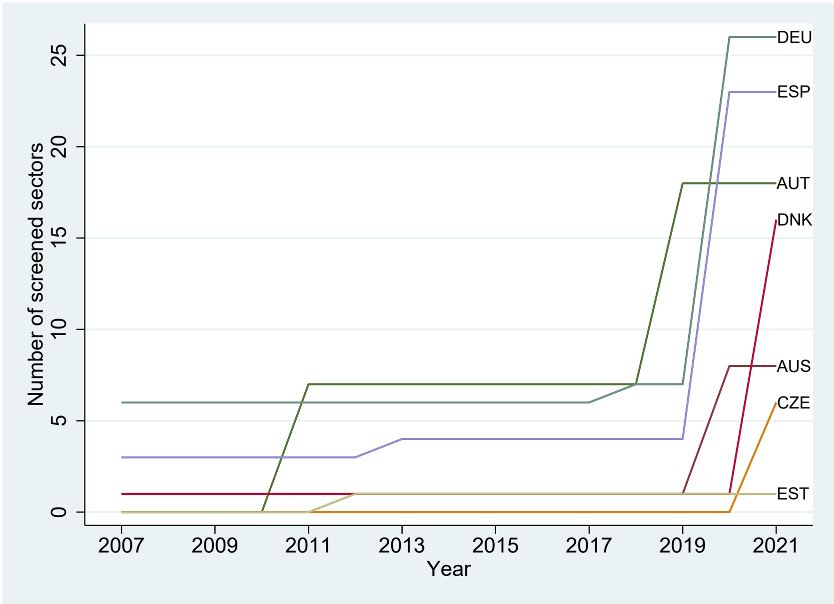

Figure 8: Cumulative adoption of new sectors that are screened for a subset of countries.

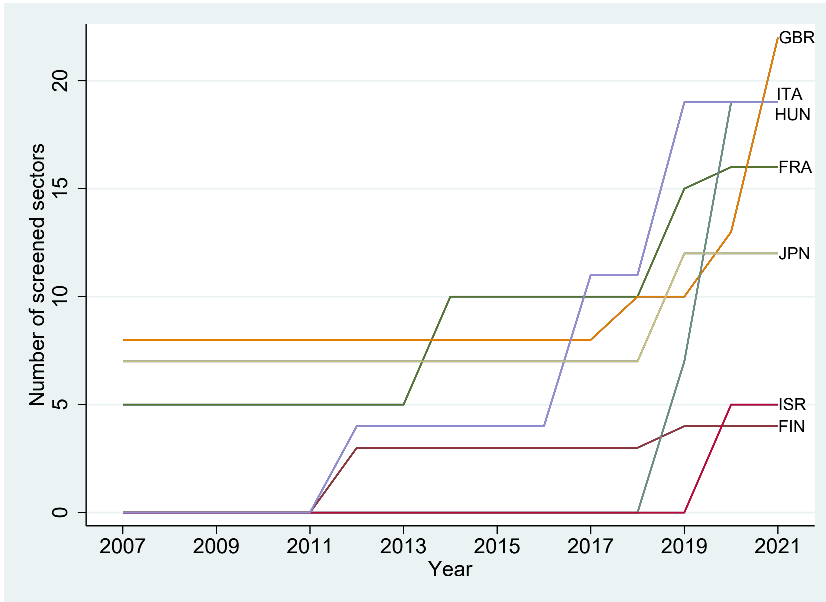

Figure 9: Cumulative adoption of new sectors that are screened for a subset of countries.

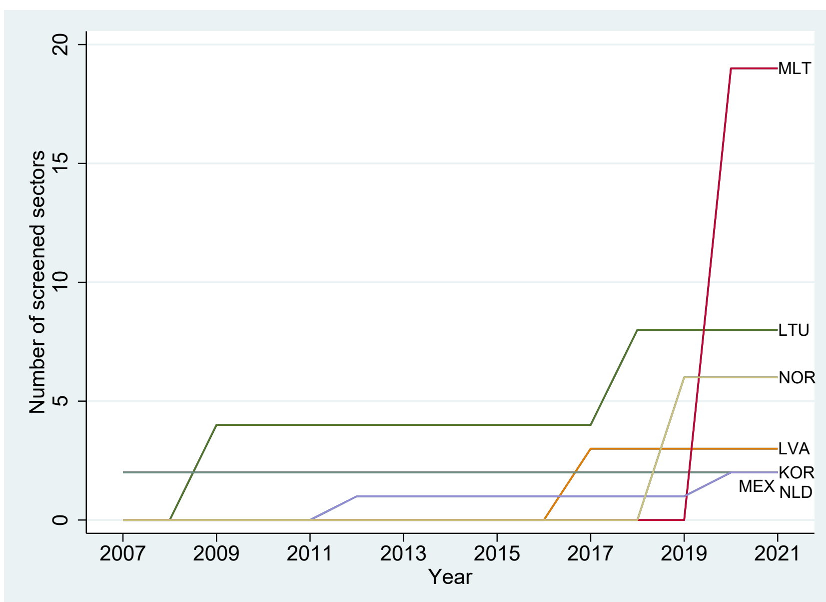

Figure 10: Cumulative adoption of new sectors that are screened for a subset of countries.