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Screening Foreign Direct Investments

Another step towards a fairer global level playing field?

On 13 September 2017, the European Commission published a proposal which establishes an EU framework for screening foreign direct investments into the EU. According to the Commission, such a framework is necessary to protect the EU's legitimate interests with regard to FDIs that raise concern for security or public order.

The Commission proposes a rather soft general framework with some basic requirements. It does not set up a unified EU-wide screening mechanism and Member States will not be required to implement an FDI screening mechanism. The Commission also proposes a cooperation mechanism whereby Member States inform each other about any FDI undergoing screening. Furthermore, the Commission would be able to carry out a screening on its own in cases where an FDI may affect European programmes. Member States would be allowed to raise their concerns regarding FDIs in other Member States whereas the Commission could issue non-binding opinions towards Member States.

The panda in the room

The EU is a very open economy: it has one of the world's most open investment regimes and put together, the EU Member States have the fewest restrictions on foreign direct investment. Free movement of capital is one of the four fundamental freedoms guaranteed by the European Treaty. Moreover, it extends to third countries as well: 'all restrictions on the movement of capital between Member States and third countries shall be prohibited' (art. 63(1) of the Treaty on the Functioning of the EU). This is not the case for major economic partners of the EU. China, together with Saudi Arabia and the Philippines, remains among the countries with the highest restrictions. At the same time, Chinese state-backed companies are investing in strategic industrial assets in the EU. In a number of cases, this has created substantial political upheaval e.g. Hinkley Point (the new nuclear power station in the UK), Eandis (the Belgian electricity grid that was intended to be sold to Chinese State Grid, but the deal was cancelled after a letter to the government from the security services) or Kuka (the leading German company in robotics, taken over by Chinese Midea). In Germany, the authorities decided to withdraw their initial approval of Fujian Grand Chip's bid for chipmaker Aixtron, after intervention by the US intelligence services and in the US, the Committee on Foreign Investment (CFIUS) barred investments from companies such as Huawei, the Chinese telecoms equipment manufacturer.

In general, the EU is worried about the strong growth in Chinese FDI into the EU which reached 35bn EUR in 2016. This represents an increase of more than two-thirds compared to 2015 and is also four times as much as European FDI into China. While FDIs are beneficial for growth and jobs, they also create dependence from Chinese state-owned or -backed companies.

The total outbound direct investment by Chinese companies is likely to have exceeded $200bn in 2016, double the amount spent in 2015. China has clearly shifted from being a leading destination of FDI to also being a major provider of outbound FDI.

The surge in Chinese global investments is undeniably resulting from its One Belt One Road connectivity initiative (2013), the creation of new funding tools such as the Silk Road Fund or the Asian Infrastructure Investment Bank. It is also related to the Made in China 2025- strategy, aiming for global leadership in key technologies and for a drastic reduction in the high level of foreign content in Chinese manufacturing.

The mounting concerns about the surge of Chinese investments into Europe's energy, infrastructure and manufacturing sectors has provoked calls for more rigorous screening of foreign takeovers of European companies.

Keeping a European eye on FDIs

Since the Treaty on the Functioning of the European Union, foreign direct investment has become part of the common commercial policy and falls within the EU's exclusive competence. The new regulation will therefore be part of the EU's commercial policy.

According to the TFEU, restrictions on the free movement of capital can indeed be invoked on grounds of public policy or public security. This is reflected in Article 21 of the EU Merger Regulation which recognises the right of Member States to take 'appropriate' measures to protect legitimate interests other than maintaining competition in the relevant markets (these include public security, financial stability, plurality of media).

The concerns about foreign investor's strategic acquisitions of European companies with key technologies was also addressed in the Commission's reflection paper of 10 May 2017 on Harnessing Globalisation already recognised as increasing.

In his annual State of the Union Address on 13 September 2017, President Juncker announced a new EU framework for investment screening. "Let me say once and for all: we are not naive free traders. Europe must always defend its strategic interests". At present only 12 of the EU's 28 nations have formal systems for screening takeovers and other investments to assess whether they pose a threat to national security or public policy goals. The national mechanisms differ significantly in their design and scope (screening threshold from 5 to 50%, they may or may not define the sectors concerned, screening on grounds of national security or beyond, only external FDIs or also internal investments, mandatory or voluntary).

The new framework should enable Europe to preserve its essential interests. The regulation aims to harmonise national screening mechanisms by providing common criteria and standards (or a set of minimum requirements) and to create a new oversight role for the European Commission itself to review FDI. The proposal is not to replace national mechanisms and does not affect the Member States' ability to adopt any review mechanisms or to remain without such national mechanisms. Decision-making will also remain in the hands of the Member States.

Key features are:

- **Common minimum requirements** for a national screening mechanism: transparency, non-discrimination, timeframes, judicial redress, the grounds and specific circumstances for screening. Member States are also required to have anti-circumvention measures in place and must produce an annual report on the use of their screening mechanism.
- A **non-exhaustive list of screening factors**. The regulation proposes a list of factors to be taken into account when screening FDI: critical infrastructure, critical technologies, security of supply of critical inputs, access to, or possible control over sensitive information if the foreign investor is controlled by the government of a third country.
- **Commission's authority to screen projects of 'Union Interest'** (space programmes, networks for transport, energy and telecommunications, Horizon 2020). The European Commission will be allowed to screen transactions that are likely to affect projects or programmes related to Union interests. The Commission can issue an opinion to the Member States concerned. In case this opinion is not followed, they will have to provide an explanation.
- A **cooperation mechanism** between a Member State screening an FDI and other Member States. Member States will inform each other and the Commission and can comment (concerned Member States shall give 'due consideration' to these comments). Where the Commission considers that a foreign investment is likely to affect security or public order, it can issue an opinion (non-binding) to the Member State(s) concerned, even if they do not have a review system in place.

In parallel with the proposal for a new framework, the Commission will proceed with 2 complementary initiatives:

- Creation of a coordination group on inward direct investment as a forum for wider discussions including identifying sectors/assets that have strategic implications from a security, public order and/or control of critical assets.
- An in-depth analysis of foreign direct investment flows into the EU focusing on strategic sectors/assets. Special attention will be given to investors owned or controlled by the government or benefiting from substantial state subsidies.

A remedy against state-controlled acquisitions?

The EU is an open economy and has to continue welcoming foreign direct investments due to the economic, technological and social benefits. Foreign companies create jobs and value added and introduce new technologies and innovations. The establishment of a European-wide mechanism for screening FDIs in no way means that the EU is heading in a more protectionist direction. The proposal, in line with international trade law, gives way to FDI screening when justified for national security reasons. Many EU partners (US, Japan, China, Russia, Australia) have mechanisms for screening foreign investments, not only for reasons of national security but reference is also made to national 'economic security' or 'strategic sectors'. Setting up a European mechanism will equip the EU with a system comparable to those in other jurisdictions and contribute to a fairer global level playing field regarding foreign direct investments. Industry is increasingly hi-tech, specialised and integrated in global supply chains. Globalisation of the economy has made it easy to shift the different nodes on these complex value chains from one part of the world to another.

Therefore, industriAll Europe thinks that it is important for the EU to dispose of the tools needed to avoid selling out strategic industrial assets and technologies. The establishment of a European screening mechanism is a way to address the growing concerns related to state-led (and subsidised) acquisitions of

European industrial assets. The regulation should lead to a more coordinated and harmonised approach of screening FDIs which will increase transparency and predictability.

Nevertheless, a number of concerns remain:

- The following factors should also be considered in the screening process:
    - Reciprocity in market access: being able to buy European know-how while heavily restricting the access of EU investors in foreign domestic markets (by closing strategic sectors, forced technology transfer or forced joint-venture) is 'unfair competition'.
    - Respect of core labour standards and international environmental agreements.
    - Clearer language on critical inputs, critical sectors or critical infrastructures.
    - Strong emphasis on state-backed or subsidised acquisitions.
- The regulation is only a means of information and guidance, it does not provide decision powers at European level. However, enforcement of European competition rules in a global environment has become an important challenge. It raises the question of whether it would be appropriate to grant decision powers at European level in case of state-led takeovers. Indeed, the fact that state aid and dominant positions are prohibited inside the EU but allowed in other parts of the global economy creates an unequal playing field as foreign companies can use monopoly profits or state aid to acquire industrial assets in the EU. It could even hence be argued as a matter to be addressed by European competition policy (e.g. 'abuse of a dominant position' or 'distortion of competition' because of state aid).
- regarding issues of security and public order related to FDIs in European projects and programmes, delegating decision powers to the European level should also be considered
- Social partners should be allowed to trigger the activation of the screening mechanisms
- National screening mechanisms only take into account national interests, which can be different from the overall European interest.
- A coherent common approach is prevented by the fact that there is no obligation to set up a screening mechanism.
- The definition of a foreign direct investment is very general ('an investment that enables effective participation in the management or control of a company carrying out an economic activity'), which does not contribute to the transparency of the regulation (what about a greenfield investment? Or a blocking minority?)
- Absence of a resolution mechanism in case of conflicts between Member States.
- Finally, much will depend on the implementation. The way the EU will make use of its newly acquired powers will be key. Will the new system lead to more harmonisation? Will the EU-opinions be considered as benchmarks? Will the collaboration and information exchange between Member States make the system more effective?