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INSIGHT

EU Finalizes FDI Screening Framework

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March 5, 2019

On February 14, 2019, the European Parliament approved a regulation (an EU law) that establishes a cooperation mechanism for screening foreign direct investment (FDI) in EU members that focuses on foreign investment in "critical technologies." This action follows those of other jurisdictions, including the United States through enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) that enhanced the role of the Committee on Foreign Investment in the United States (CFIUS), to increase scrutiny of FDI as a component of national security. The legislation was approved by the EU members on March 5, 2019; this will be followed by an 18-month implementation period.

The new EU-wide cooperation mechanism aims to enhance scrutiny of FDI in: 1) "critical infrastructure," including in the energy, transport, communications, data, space and financial industries, as well as "sensitive facilities"; 2) "critical technologies," including artificial intelligence, robotics, semiconductors, technologies with potential dual-use applications, cybersecurity, space, or nuclear technology; and 3) "critical inputs," including the security of supplies of energy, raw materials or food or access to sensitive information, or the ability to control sensitive information. The new framework

- Creates a block-wide cooperation mechanism where members can share information on foreign investments, exert peer pressure, or comment on transactions in another member state;
- Allows the European Commission to issue opinions when an investment is believed to threaten the security or public order of more than one member state, or when an investment could undermine a project or program of interest to the whole EU;
- Encourages international cooperation on investment screening;
- Sets certain requirements for member states that maintain or adopt a screening mechanism; and
- Recognizes the need to operate under short deadlines and confidentiality requirements.

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IN11064

The EU market is generally considered open to foreign investment. According to the U.S. Bureau of Economic Analysis, U.S. direct investment in the EU in 2017 totaled $3.6 trillion, or slightly more than half of all U.S. FDI; EU direct investment in the United States in 2017 totaled $2.7 trillion, or two-thirds of total FDI in the United States. The EU has not had a comprehensive regime for controlling or screening foreign investment that raise national security concerns; 14 of the EU countries have their own national requirements. Until EU members adopt their own regulations, it is uncertain how the new EU screening process will affect U.S. and other foreign investors. An activist approach could constrain foreign investment, but likely will be monitored closely by CFIUS, which reviews foreign investment in the United States at the direction of Congress and on behalf of the President.

In a European Commission report issued in May 2017 on globalization, the Commission concluded that openness to foreign investment is a key principle for the EU and a major source of growth. At the same time, the report highlighted concerns about state-owned enterprises (SOEs) taking over European companies with key technologies for strategic reasons and a disparity in the rights accorded European investors by countries that are home to firms investing in the EU.

> Europe must always defend its strategic interests and that is precisely what this new framework will help us to do. This is what I mean when I say that we are not naïve free traders. We need scrutiny over purchases by foreign companies that target Europe's strategic assets
> Jean-Claude Juncker, President of the European Commission

As a sign of growing concern about the potential national security implications of FDI, some EU countries have increased their efforts to screen and block foreign purchases of European firms. Since April 2017, Germany reportedly has reviewed more than 80 transactions, a third of them involving Chinese firms. In August 2018, the German government intervened directly for the first time to block Chinese firm Yantai Taihai Group from acquiring a German company, machine tool manufacturer Leifeld Metal Spinning AG, which produces high-strength steel for the car, space, and nuclear industries.

The EU's new FDI regulation

- Gives the Commission the authority on the grounds of "security and public order" to issue opinions on foreign investments that are "likely to affect projects or programs of EU interest."
- Aims to establish a *framework* for EU countries, and in certain cases the Commission, to screen foreign investments in the EU for national security implications; complements existing national regulations; and establishes a mechanism between EU members and the Commission for sharing information on foreign investments that may threaten security or public order.
- Allows EU members to consider their individual situations and national circumstances in determining the meaning of national security. Screening procedures would be required to comply with three basic principles: transparency; nondiscrimination between different third countries; and allowance for the possibility of judicial review of screening decisions.
- Requires EU member countries to inform other members and the Commission about any foreign investment undergoing screening within the framework of their national screening mechanisms. The Commission will have 25 working days to give its opinion. While the opinion is not binding, EU member states are required to "take utmost account" of it and provide an explanation if they disregard the opinion.

The EU regulation does not include a reciprocity provision as a factor in deciding the national security concerns of an investment, but background and supporting documents related to the regulation indicates an underlying objective of opening up other economies and ensuring that other countries follow the same investment rules in the EU. In deciding the security implications of a foreign investment, the Commission and the EU member states could consider whether the foreign investor is controlled by a government of a third country, including through significant financial interests. Although a separate EU Merger Regulation governs mergers, the new FDI regulation reportedly provides for the review of mergers that involve protecting public security, plurality of the media, and prudential rules as legitimate interests of security and public order.

The EU regulation is not as comprehensive as recent congressional actions under FIRRMA to strengthen and expand current U.S. reviews by CFIUS of foreign investment transactions for national security concerns. The EU regulation, however, arguably reflects similar concerns over the impact of FDI, particularly by Chinese firms, in leading-edge technology and the legal and illegal methods Chinese firms employ to acquire technology including through forced technology transfers. Both FIRRMA and the EU regulation requires consultation on best practices in screening foreign investment, potentially reducing the possibility of regulatory arbitrage.