THE GEOPOLITICAL IMPLICATIONS OF FOREIGN DIRECT INVESTMENT SCREENING

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Since the turn of the century, the world has slipped back into turbulent waters. Afghanistan, Iraq, Libya and Syria have all in turn burned and bled. The relationship between Russia and the West has steadily deteriorated to a point that culminated in a major conflict over Ukraine from 2014 onwards, prompting the first round of Western sanctions against Moscow. Since February 2022, the situation has degenerated into open warfare as a result of Vladimir Putin's aggression, leading to a near complete breakdown in economic ties between Russia and the West. The United States and China have entered a major battle for global supremacy, described by the American political scientist Graham Allison as "Thucydides's Trap",[2] which has implications for the future of global strategic relations and the course of globalisation. Since Biden took office in 2021, his administration's ambition has been to unite the Western camp against the threats posed by Russia and China to the liberal international order. Military spending is on the rise everywhere. A new cold war is looming.

This geopolitical shift has brought to a close a period of "happy globalisation" that supposedly reflected and supported the "end of history" that Francis Fukuyama dreamed of at the end of the Cold War. Instead, the Covid-19 pandemic since 2020 has accelerated this shift: this health crisis has emphasised the strategic importance of public health (for the production of drugs, medical devices and vaccines, for example) and put the State and border controls back at the centre of the economic, healthcare and political game.

One of the cornerstones of globalisation is the freedom of capital movements. This is not a new principle, having surged significantly with the first flush of globalisation that came to an end with the start of the First World War. In 1914, assets invested abroad stood at 20% of world GDP compared with 30% today. In the European Union, this freedom is enshrined in Article 63 of the Treaty on

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[2] G. Allison; *Destined for War: Can America and China Escape Thucydides's Trap?*; Houghton Mifflin Harcourt (2017).

the Functioning of the European Union (TFEU) and applies both within the single market and in relation to third countries. Is it now being challenged?

Investment control as a national security issue

Geopolitical tensions primarily affect investments in countries in crisis or in countries placed under sanctions such as Russia and Iran. In the case of sanctioned countries, French and European (and more broadly Western) economic operators are prevented from investing as they would wish, sometimes even having to withdraw or abandon their investments. The problem in the opposite direction – investment into Europe – mainly (but not exclusively) revolves around the financial and technological abilities of China, which accounts for only 3% of investments in the European Union but is suspected of wanting to gain control of key economic assets. China is already the world's second largest economy, the largest in terms of purchasing power parity since 2014. It launched the "new silk roads" (*One Belt One Road*) project in 2013 to develop land and sea trade routes with Africa, the Middle East and Europe. It also launched the "17+1" initiative in 2012 to increase its influence over the countries of Central, Eastern and Balkan Europe. The lead taken by Huawei in 5G technology and the takeovers of the Greek port of Piraeus and the German robot manufacturer Kuka (2016) have highlighted the need to control Chinese strategic investments. Moreover, the European Commission used unprecedented language in a 2019 communication to describe China as a "negotiating partner, economic competitor and systemic rival".[3]

Within the European Union, investment control is regarded as a measure derogating from the principle of freedom of capital movements (implemented in 1988) and is essentially a national responsibility. In France, it is based on a prior authorisation procedure that must only target investments affecting public order and security, according to the principles laid down by European law. Against this background, France has gradually expanded the sectors covered by this principle of prior authorisation, which applies not only to non-EU investors but also to European investors (the nationality criterion being assessed very broadly according to the company's headquarters, the origin of the capital and its holders, the investor's link with the country of origin, and so on). The system was expanded in particular by the Villepin Decree of 2005, the Montebourg Decree of 2014 (after the takeover of Alstom Énergie by General Electric) and the PACTE Law of 2019.

The purpose of these procedures, which exist in all major developed countries, is twofold: to prevent the "predatory" takeover of companies or sensitive technologies by foreign companies and to enable the government to negotiate compensatory measures with investors who might be tempted to "relocate" or cease certain activities. Approximately 20% of investment projects in France are subject to these prior authorisations (just under 300 in 2020). These procedures do not only target China, which accounts for barely 4% of foreign investment in France (the same level as Belgium). The French government blocked the US takeover of a company specialising in defence optronics (Photonis/Teledyne) at the end of 2020. In 2011, it authorised, subject to certain conditions, Volkswagen's acquisition of the German group MAN Energy Solutions, whose French subsidiary manufactures diesel engines for nuclear submarines.

Of course, the issue of foreign investment is not just about controlling it. Hosting foreign investment is a key factor in the prosperity and attractiveness of the European Union and its Member States. The EU remains the leading destination for foreign direct investment in the world (including investment within the EU), and France, which ranks first in the EU for hosting foreign investment, has quite rightly worked hard to improve its attractiveness, as evidenced by the launch of the "Choose France" summits in 2018 with the heads of major global groups, who were welcomed to the palace of Versailles by President Macron. Foreign investment control goes hand in hand with attractiveness policies, rather than conflicting with them, and should therefore remain a derogating measure.

The growing role of the European Union in investment regulation

Although foreign investment control, particularly with regard to countries outside the EU, remains in principle a national prerogative because it is supposed to protect the heart of national sovereignty (public security, public order, defence, critical activities and technologies), this issue has taken on a truly European dimension at three levels.

Firstly, the EU, through the development of its Common Security and Defence Policy, is continuously strengthening European coordination in security and defence matters. A good example is arms exports: the European Union adopted a "code of conduct" in 1998, which became legally binding in 2008, requiring Member States to comply with a common set of criteria for their arms exports and to provide justification when some agree to export and

[3] European Commission and HRVP, "EU-China – A strategic outlook", 12 March 2019.

others refuse. This control does not undermine the freedom of each Member State to export according to its own rules, but it does provide a basis for harmonisation and transparency. We shall see that the EU is taking a similar path in setting up European control of foreign investments from third countries.

Secondly, investment came within the scope of EU trade policy with the Lisbon Treaty, which was adopted in 2007 and entered into force in 2009 (TFEU Articles 3 and 207). This means that bilateral investment treaties (protecting Member States' mutual investments with third countries) are gradually being replaced by a uniform EU policy. The agreements negotiated by the European Union in the area of investment are designed to ensure conditions of reciprocity, transparency and legal certainty with third countries. For example, in 2016 the EU concluded a very ambitious economic and trade agreement with Canada (CETA) that also covers investment and includes a specific arbitration mechanism to settle disputes that may serve as a precursor to a Multilateral Investment Court under the United Nations. More recently (late 2020), the EU and China signed a special agreement on investment that also included a dispute settlement mechanism (although this agreement has not been ratified by the EU due to growing tensions with China).

The investment issue is thus increasingly forming part of an overall trade policy that the EU wants to be based on the principle of reciprocity. Through the negotiation of trade agreements, the use of the World Trade Organization's dispute settlement mechanism, the application of so-called "trade defence" instruments (to apply retaliatory measures), the development of new instruments against unfair foreign subsidies, on access to international public contracts or against forms of foreign economic coercion (the first two instruments agreed under the French Presidency of the European Union in the first half of 2022 and intended to rebalance the EU's economic relations with its foreign partners in these areas, the third in the process of being adopted), the EU is making every effort to assert itself as a more "sovereign" trading power, one that can command respect for its actions and stand up for its own interests as a united front.

Thirdly, the EU has established a principle of "strategic autonomy". Initially applied to defence, it was extended in 2020 (in light of the Covid-19 pandemic) to a series of economic sectors deemed strategic for the EU (space, digital, healthcare, energy, raw materials, agriculture and electronics). In several of these sectors, the EU has developed an active industrial policy by launching joint projects in areas such as batteries, semiconductors, hydrogen, healthcare and cloud computing. The principle of strategic autonomy applied to the economy is, however, intended to be "open": the idea is not to make the EU autarkic or protectionist, but to better combine openness and protections to strengthen the EU's autonomy and sovereignty, including by hosting foreign investment. The shift in the relationship with Russia since the war in Ukraine (sanctions and the need to move away entirely from buying Russian hydrocarbons) reinforces this trend at least in the field of energy and raw materials.

The EU's investment policy is therefore part of a broader policy to make the EU more "geopolitical", more "sovereign" and more "strategically autonomous", not by turning its back on free trade principles but by encouraging more reciprocal economic relations that are less naive. Foreign investment control, insofar as it aims to prevent foreign economic operators from taking control of strategic assets in the EU, is an important aspect of this policy. It applies to investments from outside the EU and not to internal EU investments, which fall within the scope of the rules of the internal market and its possible exemptions and continue to be regulated at the national level under EU supervision.

EU Regulation on the monitoring of foreign direct investment

In 2017, the European Commission proposed a regulation on the monitoring of strategic investments (known as "screening"), which was adopted in 2019. It is still a light-touch mechanism: EU Member States must inform the Commission of their national control mechanisms and notify foreign investment projects subject to these controls, which allows other Member States to react if necessary. The Commission can even issue a negative opinion (although this is not binding on Member States) if it considers that these projects undermine an EU interest on public order or security grounds.

The challenge now is to move towards a more binding approach that provides real European control of strategic investments that goes beyond the current monitoring mechanism. This new approach must also consider European lists of strategic assets and critical technologies to be protected, and a possible European blocking mechanism on a recommendation from the European Commission.[4]

[4] European Council on Foreign Relations, "Strategic sovereignty: how Europe can regain the capacity to act", 2019 (https://ecfr.eu/archive/page/-/ecfr_strategic_sovereignty.pdf, page 34).

This would be the second stage of the rocket and would bring foreign investment fully under the competences of the EU (not only offensively, as part of its trade policy, but also defensively, to protect the interests of the EU). However, it is more likely that harmonised European control will remain elusive, in the same way that there is no completely harmonised arms export policy in the EU, because prerogatives related to public order, public security and defence are, and will remain, at the heart of the sovereignty of the EU's Member States, which are primarily responsible for their security ("national security remains the sole responsibility of each Member State", TEU Article 4-2).

The European Commission's reports on the implementation of the regulation show that a process of harmonisation of European policy on foreign investment control is already under way. There are now 18 EU countries (out of 27) that have a national control system, compared with 11 at the time of the Commission's proposal for the regulation, and almost all of them are planning to have one. According to the data collected by the Commission from Member States for the first year the regulation was in force, in an overall climate of reduced investment flows due to the Covid-19 pandemic, national authorities were notified of almost 1,800 investment projects (as we have seen, around 300 were in France) but these authorities formally examined only 400 of these: 2% were refused, 12% were authorised subject to conditions, and the vast majority were approved without conditions. Of the 285 projects examined by the European Commission, mainly from five countries (US, UK, China, Canada and UAE), 14% (relating to the manufacturing, finance and information and communication technology sectors in particular) underwent careful examination, and only 3% (about 15) resulted in a formal opinion from the Commission (the discussions and observations relating to each project remaining confidential). As the Commission emphasises in its report, it must also take into account the interests of the EU as a whole. The mechanism therefore focuses on investments that affect several countries at the same time and require all parties to cooperate in assessing their impact on public order and security.

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As we have seen, foreign investment control is not incompatible with policies to attract investment but is one aspect of the gradual assertion, in a world with rising geopolitical tensions, of a less naive, more autonomous and more sovereign Europe that intends to think in strategic terms, to equip itself with the will and the means to play a leading role in international relations and to protect and develop its technologies and critical capabilities. While this policy is increasingly part of Western solidarity in the face of the "systemic challenges" posed by China and Russia, it also strives to assert the European Union's own interests vis-à-vis all its partners.

[5] First Annual Report on the screening of foreign direct investments into the Union, 23.11.2021 (https://trade.ec.europa.eu/doclib/docs/2021/november/tradoc_159935.pdf).