The Multi-Level Politics of Chinese Investment Screening: Exploring Divergent Interests in Federal Political Systems

European Union Studies Association
18th Biennial Conference, May 2023

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How do different multi-level systems control Chinese FDI? While Chinese outward foreign direct investment (FDI) is controversial, much of that attention has focused on the European Union (EU) and United States (US) with their respective investment screening programs. Focusing on four different federal systems – EU, US, Australia, and Canada – we examine the different efforts to regulate Chinese FDI which varies widely with respect to enforcement and scope, as well as the very different trade, investment, and political relationships each of the four has with China. To date, scholars who studied these issues in advanced economies have focused mostly on how they impact the EU or the US, and the development of EU and US investment screening mechanisms (ISMs). Yet what is missing is a cross-national comparison of dynamics to explain similarities and differences in policymaking responses to Chinese investments. Specifically, we believe it may be insightful to apply a multi-level governance perspective to this topic, since sub-national actors (e.g., US states) and EU member states likely have different perspectives on the benefits and risks of Chinese investment. We propose to include Canada and Australia in our study. Both countries are economically advanced democracies, have federal political systems that allow the application of the multi-level governance model for analysis, and have seen huge increases in Chinese FDI over the past two decades. We expect the results to provide insights into whether and how the national (and EU) level and subnational (and member state) levels towards Chinese FDI have similar challenges to that of other federal systems, as well as the impact on overall levels of FDI within and across polities.

Introduction

When Democratic Senator Sherrod Brown (2017) complained that 'foreign investments should lead to good-paying jobs in Chillicothe and Chardon – not huge payouts for the Chinese government', he was seeking to expand foreign investment screening beyond its national security focus to include the impact on American jobs and growth. While seeking bipartisan support for the proposed Foreign Investment Review Act, such comments reflect a broader global trend in which investment screening mechanisms (ISMs) have proliferated over the past decade. While foreign direct investment (FDI) was once an indicator of economic openness and a driver of economic integration, states have more recently sought greater control over the entry of FDI into specific sensitive sectors in their domestic economies (OECD 2021). The rise of state-owned enterprises (SOEs) and sovereign wealth funds (SWFs) has led to increased pressure to regulate the effects of financial 'market entry' through greater scrutiny of the origin and scope of such investment and the economic and national security implications of foreign ownership (Cuervo-Cazurra, Grosman, and Mengginson 2022). While some of this is tied to efforts at promoting reshoring, reducing dependence on global supply chains, and fostering domestic employment, there has also been a particular concern about the impact of Chinese foreign investment on technology transfer, given the growth of international production and the diffusion of new technologies, production methods and technical skills beyond domestic borders (Gertz, 2021). This has now been expanded to include consideration of new tools with respect to outbound strategic investment controls providing governments with a stronger grip on investment in China (Hellendoorn, 2022; NCDDA, 2021).

While states have a sovereign right to control FDI, the expansion of more restrictive legislative and regulatory practices fits within a broader series of defensive policy measures that have targeted the increasing presence of Chinese market power (cite). Unlike previous debates, the contemporary focus is on Chinese SOEs and the perceived risks of such investment for national security reasons. While such screening efforts shift from the openness to international markets for goods and capital to more defensively oriented regulatory scrutiny, the spate of investment restrictions varies across different national contexts as we describe below. Interestingly, while UNCTAD data indicate that Chinese investment abroad grew from $12 billion in 2005 to $196 billion in 2016, these amounts have subsequently declined, averaging $147 billion between 2017 and 2021 (UNCTAD, 2022). Although some of this may be due to the pandemic, the broader issue is whether investment screening done under the guise of 'national security' or 'national interest' will block foreign companies by providing an inhospitable regulatory environment.

Although these policies do not explicitly ban or mention Chinese investment, the discourse surrounding their development and implementation makes it clear that governments and key interest groups are most concerned about Chinese FDI. Some countries welcome this investment as an opportunity to generate jobs, tax revenues, global trade links, and economic growth. Other countries worry that Chinese investment may include acquisitions of long-established domestic companies, loss of intellectual property, and increase pressure to support Beijing in global political matters. This was heightened during the economic and financial crisis when states with ailing firms and constrained by austerity put a premium on attracting FDI to help them emerge from the recession. That said, stricter screening measures have been on the rise shifting from the earlier

period where regulatory changes were directed at facilitating investment to constraining what has been described as adversarial capitalism (Sauvant, 2009).

As China became the second largest FDI investment country through specific outward foreign investment initiatives, Chinese SOEs and private companies ventured abroad to acquire or gain stakes in natural resources, technology, and commercial and real estate markets (Shambaugh, 2015). How do different multi-level systems control Chinese FDI? While Chinese outward FDI is controversial, much of that attention has focused on the European Union (EU) and United States (US) with their respective investment screening programs (Egan, 2023; Meunier, 2014; Meunier, Burgoon, and Jacoby, 2014). While the EU and US have adopted new and enhanced screening mechanisms to address foreign investment transactions, reflecting a trend in the global political economy that widens the scope of regulatory scrutiny beyond national security provisions, less attention has been given to other federal systems to explain similarities and differences in policymaking responses to Chinese investment (Gertz, 2021).

Our paper focuses on comparing four cases covering the EU, US, Australia, and Canada as we examine the different efforts to regulate Chinese FDI which varies widely with respect to enforcement and scope, as well as the very different trade, investment, and political relationships each of the four has with China. In doing so, we highlight how the dynamics of federalism has an impact on FDI investment, comparing federal political systems that have seen huge increases in Chinese FDI over the past two decades to assess the effects of multi-level governance (MLG). However, much of the attention in the academic and policy literature has focused on federal-level policy changes. We expect the results to provide insights into whether and how the national (and EU) level and subnational (and member state) levels towards Chinese FDI have similar challenges to that of other federal systems, as well as the impact on overall levels of FDI within and across polities.

The paper is structured as follows: it begins by reviewing the literature on the political economy of investment screening, followed by an overview of outward Chinese FDI trends. The empirical portion of the paper focuses on the four cases to ascertain the political dynamics of investment screening, and the challenges faced in promoting more restrictive practices. The paper highlights the multi-level context to illustrate the interaction between different levels of government in shaping ISMs.in federal (or multi-level governance, in the case of the EU) political systems.

The Political Economy of Investment Screening

While concerns about Chinese outward investment have been on the rise for the past decade (Meunier, Burgoon, and Jacoby; 2014), much of the existing literature on foreign direct investment has focused on: the national security implications to restrict or prohibit foreign investors (Lai, 2021); the evolution and design of different investment regimes (Chan and Meunier, 2022); the increased enforcement and oversight of specific investment regimes (Egan, forthcoming in press; Kao, 2019); the expansion and scope of investment screening across policy areas (Evenett, 2021); and the implications on economic growth and debt implications for domestic recipients (Carmody, Taylor, Jarmonz, 2022; Acker, Brautigham, and Huang, 2020). That Chinese FDI has become a lightning rod for criticism over its efforts to leverage its market position has led to growing efforts

at the national and international level to regulate such investment. This has led to a wider politicization in which FDI has developed into a security issue in which the problematization of Chinese investment in policy debates has been perceived as an existential threat (Corre and Sepulchre, 2016; Lai. 2021).

In the EU case, Meunier highlights the transfer of competences over investment policy where until the 2009 Lisbon Treaty, investment agreements were the sole domain of member states and non-EU countries. This lack of EU cohesiveness reduced bargaining leverage over market access and the ability to shape international norms (Meunier, 2014). She argues that the steady expansion of oversight over investment that preceded Lisbon was through stealth, and that concerns about encroachment on national sovereignty reflected distinctive material interests (Meunier, 2017). But even after the Lisbon Treaty came into effect, political and legal ambiguities limited its influence over investment agreements and activities (Chaisse, 2012).

In the US, which has typically been more welcoming to foreign investment, hostility to some forms of investment appear to be rising. Bauerle Danzelman (2022) focuses on the increased efforts to address national security risks through measures taken by the US to protect their economy from foreign investment if the latter poses a threat to their national security (2022). Canes-Wrone and Meunier (2020) highlight the domestic political motives that generate support for restrictions, and the congressional backlash from districts which are not the direct main beneficiaries of foreign investment. This increased oversight has also led to the diffusion of ideas and practices through both learning and coercion as the US has invested in capacity building and information sharing towards less developed domestic investment regimes in Europe as well as more coercive measures to confer favored status on countries that have reliable screening mechanisms (Egan, forthcoming; Bauerle Danzman and Menuier, 2021).

In both cases, screening of FDI illustrates the securitization of the policy to legitimize new measures that represents a shift from the non-binding efforts of international institutions towards more multi-level enforcement in which monitoring, investigating, and sanctioning have become increasingly salient (Scholten, 2017). There is, therefore, despite important differences of emphasis, considerable agreement that FDI screening has become increasingly politicized. Yet less attention has been given to how this increased oversight impacts state behavior regarding investment incentives and the complexity of intergovernmental interactions in federal market economies where governments seek to maximize domestic benefits while seeking to minimize adverse consequences of FDI.

Chinese Foreign Investment Trends

Since the early 2000s, Chinese companies - both privately owned firms and state-owned enterprises (SOEs) - have been encouraged by Beijing to go global. This “Going Out” strategy has several dimensions. For companies in mining, oil and gas, other extractive, and some agricultural industries, the goal was to acquire the natural resources necessary for China’s manufacturing, energy, and food security needs. For companies in other sectors, a primary goal has been to make acquisitions abroad that would procure technological, managerial, or other firm specific advantages that would enhance the global competitiveness of Chinese companies and that country’s economy. Table A shows the value of Chinese investments in Australia, Canada, the

EU, and US between 2005 and 2021. Investment peaked in Australia and Canada about a decade ago, and a few years later in the EU and US. The European figures would be even higher if investment in the UK, the major European destination for Chinese FDI over this time, and Switzerland (where 98 percent of the agricultural science company Syngenta was acquired by the SOE ChemChina for $43 billion) were included.

Table A: Chinese Investments in Australia, Canada, EU, and US (US$ million)

	Australia	Canada	EU*	US
2005	$320	$250	$0	$1,740
2006	2,920	110	1,180	0
2007	430	0	3,670	8,400
2008	16,250	0	12,710	4,970
2009	9,130	3,480	1,260	8,200
2010	3,340	7,080	3,360	8,820
2011	9,460	5,430	12,380	2,170
2012	9,080	21,570	6,550	8,980
2013	8,440	470	3,030	16,120
2014	9.190	3.600	19,590	17.310
2015	10,480	1,340	28,720	18,800
2016	6,630	2,750	37,160	53,410
2017	5,040	2,440	18,580	23,140
2018	5,330	5,610	31,110	10,500
2019	2,470	2,750	21,490	4,750
2020	3,220	0	8,050	1,460
2021	0	770	9,130	1,060

* Excludes UK in all years
Source: American Enterprise Institute and The Heritage Foundation, China Global Investment Tracker (https://www.aei.org/china-global-investment-tracker/)

The Organization for Economic Cooperation and Development (OECD) ranks countries on their restrictiveness to foreign investment (OECD, 2020). The measure is based on: foreign equity restrictions; screening and prior approval mechanisms; rules for key personnel; and other restrictions on the operations of foreign enterprises. On this measure, Indonesia is by far the most restrictive with a score of 0.35 (out of 1.0). Canada ranks as 7th (0.16) most restrictive of the 43 countries included, while Australia is 8th (0.15), and the US is 12th (0.09). China itself is the ranked the third most restrictive country (0.22). Unlike with trade, where external tariffs are the same for every EU member state, there is no common EU foreign investment policy and so the restrictiveness varies across members. The 22 EU countries in the OECD rankings range from a high of Austria (0.11) to low of Luxembourg (0.0) with an average of about 0.03. Overall, Canada and Australia are similarly highly restrictive on foreign investment, the US a little less so, and EU countries much less restricted. But this index, and the ranking of countries on them, while useful in the broadest sense of understanding relative FDI restrictiveness among countries, makes it difficult to evaluate how investments from specific countries are treated.

While the index focuses on statutory restrictions, as we discuss below, a key reason for the decline in Chinese investment in these entities is political and, in many cases, public opposition

due to security concerns and the "uneven economic playing field" posed by countries like China that practice state capitalism (Bremmer, 2010). Kirkegaard (2019) attributes Beijing's crackdown on "irrational" capital outflows as a more important reason. However, data suggests that China may be re-directing investments from the West to emerging markets and less developed countries. For example, Chinese outward FDI to Africa has generally been increasing since 2009, without the steep declines seen in Europe and the US (China Africa Research Initiative, 2022).

While the more recent international political economy literature on investment screening has focused on the increased securitization of investment (Bauerle Danzmann 2021), the institutional development of ISMs (Chan and Meunier 2021; Olivieri 2019/2020) and the surge of restrictions on investment driven by the geopolitical pressures stemming from increased global power competition (Defraigne 2017; Le Corre and Sepulchre 2016), there is little work on how investment screening is shaped by competing interests between national and local governments in federal political systems (e.g., Australia, Canada, and the US) or those that are characterized by MLG.

The United States

The Committee on Foreign Investment in the United States (CFIUS) is one of the oldest and most active national-level bodies that screen foreign investment. Established in 1975 by executive order, it operated in 'relative obscurity' for several decades (CRS 2020). CFIUS is an interagency committee comprising fifteen departments and agencies (including official representation from the Departments of Justice, Homeland Security, Energy, Defense, State, and Commerce and the Office of the US Trade Representative and Office of Science and Technology Policy) that are authorized to review transactions. Under the 2007 Foreign Investment and National Security Act (FINSA) and the 2017 Foreign Investment Risk Review Modernization Act (FIRRMA), the scope, mandate, and obligations of the Committee have broadened significantly, especially regarding its authority to approve or reject certain FDI transactions.[1]

When a foreign investment, particularly a merger or acquisition, raises potential national security issues, CFIUS will determine whether the investment can go ahead, be subject to conditions, or barred. Treasury data from 2011-2020 show that the number of notices from companies peaked at around 230 each year between 2017 and 2019, as did the number of investigations (not all notices are investigated), which averaged about 150 (US Department of the Treasury, 2021). No more than two notices were rejected in any given year by CFIUS between 2011 and 2020. However, many firms withdraw their notice (peaking at 74 in 2017) because the proposed investment has fallen through, or political opposition suggests that CFIUS approval is unlikely. Between 2018 and 2020, China accounted for 97 of the 647 total notifications - more than any other country (Japan came second at 96). Of China's 97 notifications, 48 were in manufacturing, 30 in finance, information, and services, 12 in mining, utilities and construction, and 7 in wholesale/retail trade and transportation. Five Chinese-initiated transactions were of US "critical technologies" companies.

Due to growing concerns about foreign investment, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) sought to strengthen and modernize CFIUS to address

[1] Parts of this section are from Egan (2023)

modern security concerns more effectively. One new aspect includes investigating investments when the foreign entity does not have a controlling stake in the US company but may have indirect influence and/or access to assist in the diffusion of technologies to their home country. However, a section of the FIRRMA legislation that would have included an outbound screening component was removed after US industry opposition (Bauerle-Danzman, 2022).

A growing number of actions are aimed at US investments in China. Executive orders by the Trump and Biden administrations prohibit US investment in security and surveillance companies associated with China, block sales of technologically sophisticated items to actors associated with the People's Liberation Army and authorize studies on critical supply chains including rare earth metals, semiconductors, and vaccines (Bauerle-Danzman, 2022). To add further complexity, the US has extended its opposition to certain Chinese deals even when the target is not a US company. In August 2021, the US Treasury Department said that the $1.4 billion acquisition of South Korea's Magnachip Semiconductor by a Chinese private equity firm Wise Road Capital posed risks to US national security (Reuters, 2021). Current legislation making its way through Congress aims to address outward investment flows in two ways (Alper, 2022; Bauerle-Danzman, 2022). First, the government would review outbound transactions to "countries of concern" as they relate to critical supply chains. Second, such supply chains would be systematically defined and reviewed to ensure diversification and resiliency. As with the FIRRMA law, chip makers and industry groups like the US Chamber of Commerce are opposed to such restrictions.

As a result of these and other actions, foreign investment by Chinese firms dropped to $1.06 billion in 2020 - the lowest since 2006 (see Table A). But that has not limited the impact from prior years' investments or other financial flows from China to the US. As of May 2021, 248 Chinese companies (including eight state-owned enterprises) were listed on the New York Stock Exchange, NASDAQ, and NYSE American with a total market capitalization of $2.2 trillion (US-China Economic and Security Review Commission, 2021).

The US federal political system has, in the case of Chinese investment, created different incentives for Washington on the one hand, and state and local government on the other. By one estimate, $1.8 billion of subsidies have been provided by state and local governments since 2010 to attract Chinese companies to their borders (Good Jobs First, 2022). State and local governments are likely much more motivated by the creation of jobs, regardless of a company's nationality, than national security concerns that traditionally have been within the remit of Washington. Sensing a growing hostility to Chinese investment at the national level, some Chinese companies are changing tactics by currying favor with governors and mayors (Allen-Ebrahimian, 2020). D&C Think, a Beijing think tank, researched public statements related to China by 50 US governors, and ranked six as "hardline," 17 as "friendly," and the remainder "unclear" or "no stated position." Such strategies have the appearance of trying to divide political opinion along federal lines and assist Chinese companies, both state-owned and private, to find more welcoming locations for investment in the US (Atkinson, 2020). For example, the D&C Think report stated, "Governors can ignore orders from the White House," and that state-level officials "enjoy a certain degree of independence."

FINSA expanded agency membership along with designating a lead agency to review the transaction and determine the scope of national security concerns by allowing U.S. regulators to weigh the risks of investment by state-controlled entities (Rose 2015). FINSA provided for executive agency accountability to Congress, as well as link matters of trade and security, while also seeking to provide more predictability for firms given that there was no statute of limitations on its oversight and scrutiny (Rose 2015). In 2018, FIRRMA passed with almost unanimous agreement to broaden those transactions subject to review by CFIUS to include real estate and critical infrastructure. It further 'allows CFIUS to discriminate among foreign investors by country of origin', ostensibly to appease bipartisan concerns over China's increased investment the US technology sector (CRS 2020: 15–16). Under the Act, any 'noncontrolling' foreign investments in critical technologies or infrastructures or in businesses that collect personal data from U.S. citizens are also subject to review (CRS 2020: 16). FIRRMA has recently expanded further to include new objectives such as sustainability (Olivieri 2021). In addition, there has been a sharp rise in non-notified transactions that CFIUS has proactively identified for further review.

Australia

Since 1974, the foreign investment screening framework in Australia is governed by the Foreign Acquisitions and Takeovers Act 1975 and the Foreign Acquisitions and Takeovers Fees Impositions Act 2015 and administered by the Foreign Investment Review Board (FIRB) (Australia Productivity Commission, 2020). While the latter is an advisory body, the Treasury is the key government agency in terms of investment screening decisions. The legislation provided for net economic benefit tests as well as equity investment and involvement in the mining, agriculture, fishing, and forestry industries for domestic constituencies (US Department of the Treasury, 2019).

With such a broad scope of domestic policy concerns, the investment framework had operated on a 'negative test' approach where the foreign investment had proceeded unless found contrary to national interest which remains undefined in the law. (Australian Government, 2021). As a result, notions of national interest have included competition policy, taxation consideration and community concerns in evaluating foreign investment which is much broader than other investment regimes as national security concerns have not always been the focal point of decisions. Part of this is due to the principal role of the Treasury Department which limits the broader consideration of security issues (see, for example, Kirchner and Mondschein, 2018).

Consequently, Australia has struggled to focus principally on the security concerns raised by the more assertive Chinese FDI role. [2] Chinese FDI has been a domestic concern since around 2008-2009 when debates emerged about whether investment by SOEs warranted increased scrutiny after a surge in investment during the financial crisis (Lui, 2018; Drysdale, 2011). Australia at the time, characterized by openness towards foreign investment in its resource industries, came under intense pressure as conservative politicians weighed in about the sale of national assets to China. There was political debate over investment in the mining sector involving state-owned Chinalco, Minmetals and Sinosteel (Drysdale and Findlay, 2008). Despite these concerns, Chinese investment continued apace with key strategic investments including State

[2] Data varies on Chinese FDI in Australia depending on source. AEI data focused on contracted data. The Australian Bureau of Statistics uses different measures, see Liu, K. (2018) for a discussion of different measures.

Grid's 20 per cent stake in energy sector giant Ausnet and Hunan Valin Iron and Steel Group's 12.5 per cent stake in Fortescue Metals.

By 2019, the Lowy Institute polling found that 68% of Australians thought the government was allowing too much investment from China and only 33% perceived China more as an economic partner than security threat in 2022 (https://poll.lowyinstitute.org/charts/china-economic-partner-or-security-threat). Across the territories, there were strong concerns about Chinese FDI ranging from 81% in South Australia to 47% in Australian Capital Territory, with public opinion towards China falling sharply. In addition, the imposition of tariffs on Australian imports has heightened bilateral tensions, and consequently Chinese investment has progressively declined from its highpoint in 2008 at 16.2 million to 1.9 million Australian dollars in 2020 with the number of completed deals falling by 50%.

According to KMPG and the University of Sydney, between 2007-2021, Chinese investment in Australia totaled 110.1 billion dollars with 70% targeted to the mining sector and 26% to the commercial real estate sector being the primary investment sectors. This masks massive regional variations as Western Australia (WA) received 66% of Chinese direct investment in 2021 followed by more modest investment in Victoria (17%) and New South Wales (NSW) (13%) respectively. A report by KPMG and The University of Sydney noted that in 2020, (NSW) received 49% of Chinese investment in commercial real estate and financing, in Victoria services were the dominant sector with around 24% of investment, and WA receiving 26% of investment in the mining sector (KPMG and University of Sydney, 2022). Even if approved there are often restrictions placed on the investment that provide for specific restrictions related to management and location. In 2019, the acquisition of the child and infant care formula company Bellamys's by China Mengniu Dairy Company required that the headquarters remain in Victoria for a specified period and the majority of the board composition be Australian resident citizens (Voon and Merriman, 2022).

In December 2020, the Australian Parliament passed legislation that radically amended the foreign investment framework of 1975. The framework had operated on a 'negative test' approach where the foreign investment had proceeded unless found contrary to national interests. Concerns about changes in the international security environment due to rising geopolitical competition pushed the Australian Treasury to introduce to reform the investment process with greater national security scrutiny through a registry of foreign ownership assets and mandatory notification of sensitive sectors that would be subject to increased scrutiny through greater enforcement capacity. The increased scrutiny has led to 72 per cent of cases by value having conditions attached to them in 2020-21, compared to with 35 per cent in 2014-15 (Government of Australia Treasury, 2022). There are also retroactive provisions in the legislations as the Treasury has under recent reforms been provided the opportunity to review specific investments with national security implications after the investment has been made (Voon and Merriman, 2022). However, Australia investment screening varies depending not only on whether the investor is a public or private entity but also whether there is a trade agreement with the country proposing an investment (Kirchner and Mondschein, 2018). The process has become intensely politicized in Australia with a significant number of transactions failing due to political or regulatory reasons (MCcalman et al, 2022). Among the more recent concerns are those involving Huawei in the Australian 5G network or the Port of Darwin for example (Reuters, 2016; Hartcher, 2021). While the domestic climate has increasingly fostered concerns about the security and economic implications of Chinese FDI, the

pressure to reform the Australian regime was also driven by US interests. While negotiating a US-Australia FTA (AUSTA), American concerns over the broad scope of investment screening in Australia almost derailed the negotiations. As a result, Australia began to revise its screening thresholds so that broad domestic policies about business investment were liberalized and subsequently incorporated into other FTAs including the Trans-Pacific Partnership. Australia seeks to maintain its privileged status (along with Canada) that allows exemptions from tougher screening measures if they maintain strong domestic regimes that do not serve to allow for risky foreign investment into the United States (Poletti and Pickard, 2023). Australian domestic reform efforts to control Chinese FDI are also tied to their security alliances, putting pressure on Australian companies and SWFs to review their portfolios in anticipation of the Biden Administration's efforts to increase scrutiny and oversight of outbound investment in Chinese technology companies. For Australia, this continued coordination on investment security takes place against the backdrop of tensions between Beijing and Washington.

Canada

In 1973 Canada adopted the Foreign Investment Review Act (FIRA) that required government approval for the establishment of a new business or takeover of an existing one by a foreign controlled firm above a certain threshold size. The evaluation of the foreign investment focused on net benefits in terms of employment, innovation, and production taking account of any detrimental effects to any province (Foreign Investment Review Act, 1973-74 § 2). While Canada focused on the potential for foreign investment as part of its industrial strategy and perceived investment as a domestic public good, it has also been controversial. The act was in response to concerns over the upward trend of American companies in key sectors of the Canadian economy (Canada House of Commons, 2021). This has created domestic tension due to territorial conflicts over the location of that investment (Spence and James, 1984). American complaints about the surge of economic nationalism focused on the extent to which foreign takeovers were blocked due to concerns about Canadian interests. (Borgers, Rix, and Salzman, 2009). The United States filed several grievances against the Canadian regime. Under political pressures as well as the onset of recession, the Conservative government changed the focus of its review process to encourage FDI.[3]

In 1985, FIRA was renamed the 'Investment Canada Act' to facilitate a more conducive investment climate with transactions approved if they provided a 'new benefit" to the Canadian economy (Borgers et al, 2009). Since the initial enactment of the ICA, Canada did not reject any investment application except for several cultural industries (Collins, 2011). As perspectives changed with the acquisitions of some key Canadian companies including Alcan, Dofasco and Inco, there were growing concerns about Canadian competitiveness, resulting in a commissioned report to review Canadian competition and foreign investment policies. The resulting report, *Compete to Win* provided a critique of obsolete or inappropriate rules that restricted foreign investment (Government of Canada, 2008). Published before the global financial crisis, the resulting legislative changes to the ICA in 2009 eliminated most sector-specific requirements, with the notable exception of cultural businesses. This means that the review procedures are subject to different ministerial controls with the Minister of Innovation, Science and Industry or, for cultural transactions, Minister of Canadian Heritage both playing a role in the process. Other agencies can

[3] Mulroney at the time famously asserted "Canada is open for business."

also be consulted before the recommendations are sent to the Governor in Council, an appointed individual, that is responsible for a wide variety of issues related to management of diversified corporations. New provisions granted the federal government extensive powers to screen and block foreign investment that impacted national security. In doing so, Canada followed the pattern of Australia and the United States in having explicit procedures to review, adjust, and reject any investment on the grounds that it is injurious to national security. However, most FDI into Canada over the past twenty years from 2000-2019 came from the United States. Though China increased the value of investments in Canada particularly since 2009, it remained seventh in terms of overall foreign investment in Canada during this period. (Government of Canada, 2023). The ICA does provide more scrutiny of SOEs, however, the increase in threshold levels for scrutiny has had the effect of suppressing reviews, and has led to criticism that acquisitions have taken place through multiple transactions by Chinese companies that allows them to avoid scrutiny. (Government of Canada, 2020) Just like its American counterpart, Canada is also concerned about indirect acquisitions leading to increased numbers of formal security reviews with varying conditions including divestment as well as the withdrawal of some proposed investments. The review process also provides an opportunity for intergovernmental cooperation. Not only do provincial reservations regarding investment remain in place regarding investment in energy and mining, but each provincial or territorial jurisdiction that is impacted by the transaction can provide feedback so that federal and provincial agencies are engaged in investment screening (Borgers et al, 2009).[4]

In 2022, the Canadian government announced that investments by foreign state-owned companies would be subject to increased scrutiny, especially in the critical minerals sectors across all stages of the value chain as part of revisions to the Investment Canada's Act national security regime (Government of Canada, 2022). This was followed by the divestiture of three investments by Chinese investors in its critical minerals sector, which was notable as there had not previously been a foreign investment blocked in this sector on national security grounds (McGee and Chase, 2022). In 2021-2022, twelve investments were subject to a formal national security review reflecting geopolitical developments and pressure from allies with additional policy initiatives to address critical minerals and other investments by state-owned enterprises (Government of Canada, 2022).

European Union

At the EU level, there were growing concerns that a unified approach to the screening of inward foreign investment was necessary. France and Germany proposed a joint initiative to introduce more rigorous screening of foreign takeovers of EU companies, especially those with suspected state backing, and French President Emmanuel Macron has been a strong advocate for the EU to introduce a screening system (Pickard, Massoudi, and Mitchell, 2018). In March 2019, Macron claimed that, "China plays on our divisions….The period of European naïveté is over" (Erlanger, 2019, B3). That same year, the European Parliament voted overwhelmingly (500 in favor, 49 opposed, 56 abstaining) in favor of a proposal that empowers the European Commission to investigate foreign investments in critical sectors and give its opinion on whether they threaten European interests (European Commission, 2020a; Reuters, 2019). Backers of the policy, which took effect in October 2020, argue the objective is to give further scrutiny to investments that are more political than economic in nature. The regulation provides a mechanism for member

[4] This is an area we hope to do more research on in terms of interviews and data collection.

countries to share information on foreign investment, allows the Commission to issue an opinion when an investment poses a threat to the security of one or more members or could undermine a program of interest to the whole EU such as Galileo or Horizon 2020, and establishes core requirements for members who establish a screening mechanism. Member states will not be required to screen investments in critical industries (including aerospace, health, nanotechnology, media, electric batteries, and food), but they must submit an annual report to the Commission. Critically, the Commission will not be empowered to block foreign investments. It can only give its opinion on whether vital infrastructure might be compromised, or valuable technologies could fall into foreign hands. Consequently, the Commission has no enforcement mechanism. This is a weaker vetting process than, for example, the CFIUS structure in the United States discussed above. Thus, blocking decisions on national security grounds remains an exception in most member states but the decisions are subject to judicial review. While investment screening in the EU remains the prerogative of individual member states with no European provision to suspend domestic FDI, the legislation provides a minimum standard for those states that have had or plan to adopt ISMs (European Commission, 2020b; see Table B below).

This EU policy reflects a compromise between those member states that are increasingly worried about foreign investment originating in countries with a strong tradition of state capitalism like China, and those members who stand to benefit at least in the short term from such activities. The COVID-19 pandemic and the scramble in its early months for personal protection equipment, ventilators, and other medical devices has given investment protection concerns greater urgency, and in March 2020 the Commission issued guidelines to ensure a strong EU-wide approach to foreign investment screening to protect assets in health, medical research, biotechnology, and infrastructures that are essential for security (European Commission, 2020b). Competition Commissioner Margrethe Vestager even went so far as to suggest that member state governments buy stakes in key companies to prevent Chinese takeovers (Reuters, 2020a).

Most EU members have grown more wary of Chinese investment, including linkages to China's Belt and Road Initiative (BRI), because of increasing global economic and political competition and some are passing new laws addressing foreign investment (Guay and Smith, 2022). Germany began tightening its inward investment rules in 2017 that, among other things, permitted the government to block acquisitions of 25 percent or more of shares in German companies operating in "critical infrastructure." The policy was widely viewed as a response to Chinese investments in German technology firms, culminating in the Chinese conglomerate Midea acquiring the Bavarian robotics manufacturer Kuka in 2016 (Zhang, 2018). Then Chancellor Angela Merkel, who had become increasingly wary of Chinese state-owned enterprises (SOEs), justified the move to limit China's ability to divide EU members and prevent the bloc from speaking with one voice on human rights and other issues that ran counter to Chinese interests, such as territorial claims in Asia and openness toward investment by Chinese companies in Europe (Horowitz and Ackerman, 2017). In April 2020, the German government agree to additional rules that would, among things, put on hold security-related investments pending a final government decision, and allow review of a deal if there is "likely harm" to the public system or security (Reuters, 2020b). Further measures, including requiring investments of more than 10 percent in biotechnology, semiconductors, artificial intelligence, robotics, and similar sectors be made public also are planned. The 2020 rules were applied in April 2022 to

prevent Beijing-based Aeonmed from purchasing medical device manufacturer Heyer Medical on the government assessment that there were dangers to public safety (Reuters, 2022). The Covid pandemic has made the German (and other) governments more wary of depending on foreign companies for health products.

Sweden is another country concerned about the loss of national champions, such as Volvo (Erdbrink and Anderson, 2020). Zhejiang Geely Holding Group acquired the automaker in 2010 and announced in 2020 that it would be merged with Geely Automotive, thereby eliminating its Swedish identity. Swedish officials are also concerned about national security implications of other Chinese acquisitions, particularly of companies producing dual-use technologies that will be shared with the Chinese military, such as the semi-conductor company Silex and satellite positioning firm Satlab Geosolutions. Geely is the second-largest shareholder of Volvo Truck, Sweden's largest industrial company, which makes military vehicles. Even renewable energy has taken a controversial turn due to hundreds of millions of euros being invested into Swedish wind farms by Chinese SOE China General Nuclear Power Group (Duxbury, 2021). Concerns include the ability of China's presence in the electricity sector to put political pressure on the country, as well as the collection of information about Swedish customers (individuals, companies, and public companies). In May 2021, the government submitted a proposal to the parliament that would tighten the rules for foreign takeover of Swedish assets. Governments like Sweden's are in some cases responding to public opinion. A survey of the five Nordic countries (including non-EU members Iceland and Norway) found that most citizens see screening mechanisms as a legitimate tool when not applied excessively (Andersen, Hiim, and Sverdrup, 2020). There is genuine concern about the potential negative security implications of foreign investment in some sectors, particularly those related to natural resources, with older citizens more concerned than younger ones, and investments by Chinese and Russian companies more worrisome than those from European firms. To date, of the EU's Nordic member countries, Denmark and Finland have a foreign investment screening mechanism in place (Ma, 2020). Sweden has laws that limit screening to specific sectors such as military equipment and cyber security.

According to a European Commission (2021) report, 18 member states (Austria, Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, and Spain) had a national screening mechanism in place for foreign investments. The other members can be roughly classified as either in great need for any FDI (Bulgaria, Cyprus, and Greece) or have made openness to investment a key component of economic development (Belgium, Estonia, Ireland, Luxembourg, Sweden). Table B summarizes the investment screening mechanisms of EU member states.

Table B
National Investment Screening Mechanisms among EU Member States

EU Member State	Year of Adoption	Minimum Threshold (current)	Notes
Austria	2011	10%	Superseded by Investment Control Act (2020)
Belgium	*2022*	10%	Effective January 2023 after the governments of Belgium's nine federated entities have, after lengthy negotiations, agreed on the text of a cooperation agreement
Bulgaria	*No national legislation adopted or pending*	*N/A*	
Croatia	No national legislation adopted; Initiated legislative and consultative process	*N/A*	
Cyprus	*No national legislation adopted or pending*	*N/A*	
Czech Republic	2021	10%	Effective May 2022
Denmark	2021	10%	Effective June 2021
Estonia	2023	*N/A*	Effective September 2023 Foreign Investment Reliability Assessment Act
Finland	2012	10%	Amended in 2020
France	1966	10% (temporary; lowered from 25%)	Latest amendment in 2021
Germany	2004	10%	Latest amendment in 2020
Greece	*No national legislation adopted; initiated legislative consultative process*	*N/A*	*Draft legislation pending*

EU Member State	Year of Adoption	Minimum Threshold (current)	Notes
Hungary	2018	10%	Added insurance sector
Ireland	Pending Legislative adoption	*N/A*	Draft legislation pending (Screening of Third Country Transactions Bill) under consideration by Committee on Enterprise, Trade and Employment January 2023
Italy	2012	10%	
Latvia	*2017*	*10%*	*Amended in Feb. 2021*
Lithuania	2018	10%	Amended in June 2020
Luxembourg	Draft legislative consultative process	*N/A*	*Draft legislation pending as of 2022*
Malta	2020	10%	
Netherlands	Sector-specific legislation from various years 2022	*N/A*	Comprehensive Investment Screening Bill passed Senate in June 2022 and in force 2023. currently determined in separate pieces of legislation related to telecommunications, energy production and energy transportation
Poland	2015	20%	
Portugal	2014	None; investigations initiated by government based on subjective criteria	Governmental working group established to amend legislation
Romania	2012 Amended 2022	None; review process not public but initiated based on foreign	New regime 2022 (FDI Ordinance)

EU Member State	Year of Adoption	Minimum Threshold (current)	Notes
		control of entities in certain sectors	
Slovakia	2021	None; legislation broadly covers any foreign control over critical infrastructure; expanded in 2022	New regime March 2023.
Slovenia	2020	10%	
Spain	1993	10%	Amended in 1999, 2003, 2010, 2013, 2014, 2020
Sweden	Consultation 2021	*N/A*	Expected 2023

All but two EU Member States (Bulgaria and Cyprus) now have screening mechanisms in place or are in the process of establishing them. Others have adopted new mechanism, amended existing legislation or initiative consultative process or legislative measure to adopt new mechanism.
Original table compiled with data from: Di Falco 2022, Deloitte Legal 2021 , European Commission 2021a, *van den Berg and Immerzeel 2021*, *Prompers and Smit 2021*, *OECD 2021*, *UNCTAD 2021*, *White & Case 2021*, *Van Bael & Bellis 2020*.

Impact of Screening of Chinese Investment

Although Chinese FDI activity abroad in the four entities analyzed in this paper is in decline, the activity of Chinese firms globally has changed form in some key respects. Chinese companies are seeking smaller, less high-profile acquisitions and making greenfield investments which, in 2020, amounted to $133 billion making China the world's biggest global investor (*Economist*, 2021). This trend has been particularly helpful for high-end technologies. By building factories abroad, for example, Chinese lithium-ion battery companies are expanding global market share. Other companies are expanding their global footprint by selling most of their products abroad or structuring their organizations outside of mainland China to limit Beijing's influence over their operations. To the extent that these acquisitions are outside controversial industries, this will help Chinese firms avoid confrontations with Western governments.

Braw (2020) identifies other strategies that Chinese companies are using to circumvent government restrictions and public outcries. One is to partner up with private companies. For example, even though Huawei was banned from providing 5G equipment to the UK, the Chinese telecoms firm is jointly building and deploying the 5G network with Cambridge Wireless. Chinese venture capital firms are also increasingly active and "under the radar". The Office of the US Trade Representative (2018) calculates that about 600 venture capital investment deals totaling almost $30 billion took place in the US between 2015 and 2018 involving at least one Chinese investor. Additionally, limited partnerships allow Chinese companies to access technologies while keeping their names hidden from public view which has resulted in provisions in some cases to have retroactive screening measures (see Table D). Given that some systems require pre-screening and

others do not, there are also variations in oversight and the degree to which there are legal options to challenge the investment screening decisions.

While the EU regime is one of decentralized enforcement which leads to questions over differential application of rules especially in relation to third country provenance and investment, given Chinese circumvention, the ability to engage in retrospective review even after the investment has been in place in Australia is a new means to address policy concerns. However, there are also differences in degrees of vertical and horizontal coordination across the four cases that may impact their effectiveness. The EU legislation allows member states and the European Commission to scrutinize potential FDI transactions in any other member state, regardless of whether the latter state has a screening framework in place (EC 2021c: 12–13). In Canada, the process of consultation with provinces is ad hoc and less institutionalized, though it could depend on competences given that mining and insurance are regulated at the provincial level. In Australia, the process is centralized but has shifted its focus to reflect the changing geopolitical climate and recent tensions with China over trade. However, in the United States, the tightening and expansion of investment review has also fostered state level action as well. Though the federal government has an established process for reviewing investment for security reasons, Texas has enacted legislation to prohibit both public and private entities in the state from entering into agreements relating to critical infrastructure with companies that have certain ties to China, Iran, North Korea, or Russia (Eichensehr, 2022). The emergence of state control on foreign investment highlights the multi-level concern over foreign investment, even though such actions are likely unconstitutional. [5]

Table D Differentiation across federal systems

	EU	US	Australia	Canada
Level of review or competence	Federal/EU with decentralized enforcement under national regime	Federal based on inter agency cooperation	Federal	Federal with limited Intergovernmental cooperation
Voluntary or Mandatory filing		Mandatory with Voluntary options	Mandatory with voluntary options	Mandatory if control of Canadian company; non-controlling investment voluntary
Exemptions (modified or less intrusive reviews)		Australia, Canada, New Zealand, UK (five eyes)		EU, US and Australia, Japan, New Zealand, Singapore and

[5] Given preemption, states effort give rise to constitutionality under Zschernig v. Miller, 389 US 429 (1969).

				Vietnam under CPTPP
Scrutiny	Non-binding	Binding	Binding	Binding
Review	Justiciable	Non reviewable	Negative list	Net benefit/positive list
Retroactive screening	Not at EU level	Yes	Yes	No

Source: our assessment based on reading investment screening reports; Dimitropolous (2020); Voon and Mettelman (2022).

Conclusions

The system of MLG raises challenges for the EU, and to a lesser extent Australia, Canada, and the US, to develop unified approaches to Chinese investment. As described above, some EU member states - particularly those most in need of any investment, particularly in Eastern Europe - are less willing than more developed members who are at risk of losing advanced technologies and high-profile companies to support harsh restriction on Chinese investment. Similar pressures exist in the US as well with many of the 50 states welcoming investment, particularly of the greenfield variety, from Chinese firms, while Congress and the executive branch have taken a more restrictive approach. That said, even if there are relatively few investment deals that are subject to divestment and change, the concept of national security has expanded to include economic security so more sectors are now covered (Table C). Though there have been some notable restrictions in recent years towards specific Chinese investment projects across all four cases, there has been a corresponding increase in voluntary notifications as well as specific exemptions or national treatment clauses for trusted allies where foreign investment is treated the same as domestic investment (see Table D).

There are differences in terms of federalism and intergovernmental relations among the four cases. Australia and Canada are broadly similar to the US. While all four have federal level legislation, the EU is distinctive in that the review process is decentralized based on national investment regimes, with the EU playing a coordinating role. While Canada does allow for intergovernmental cooperation with inclusion of provinces affected by specific decisions as well as recognition that some competences are provincial, Australia, Canada and the United States have strong federal authority with limited powers of review. Canada and Australia both require review of foreign investments over specific thresholds. Those are not national security reviews, but are, for Canada, a “net benefit” test and for Australia a “national interest” test. Those reviews are, for the most part, separate from the national security reviews. While there are formal screening mechanisms that cover the scope, type, and sector of FDI across all four federal systems, with a tightening of review, thresholds, and restrictions especially in response to the surge of Chinese FDI, this reflects a shift from cultural nationalism and economic welfare assessments to a broader national security regime that encompasses a wide range of national security interests even if vaguely defined (see Table 1).

What is clear is that in the US, Canada, Europe, and Australia, there is a growing convergence on sensitive sectors that need to be protected against what has been described as adversarial capitalism. That said, although restrictions on investment screening have been tightened in the aftermath of the financial crisis and surge of Chinese FDI, the four cases do still vary in terms of the structure of their investment regime. Though all have gone through expansions of sectoral coverage as well as the lowering of thresholds that trigger FDI reviews, there is variation in the role of subnational or intergovernmental relations in terms of investment coordination and screening. However, there is a missing piece to the story of investment screening which is often viewed in terms of increased geopolitical competition, beginning in the 1970s with Japan and now evolving into greater scrutiny of Chinese foreign direct investment in the 2000s. The investment screening literature is decoupled from federalism and intergovernmental relations. Not only do investment patterns vary across the different federal systems in terms of territorial location, but selective foreign direct investment from specific firms and countries attracts both federal and provincial or state subsidies through direct incentives and subsidies. Yet what is missing from the focus on investment screening in domestic law and policy across the cases is a multi-level governance perspective to assess how investment is perceived by different territorial units, what role they play, if at all, in investment screening, and how the relationship of the screening of investment on the grounds of national public policy relates to the continuation of incentives and subsidies. Given the emphasis on increasing domestic capacity through subsidizing their respective industrial bases with increased domestic or regional investment funds in the US, Canada and EU, this has implications for strategies toward FDI and the relationship between domestic investment and foreign capital.

Table C: Investment screening and foreign ownership restrictions and review of sensitive sectors

Country	Defense/critical minerals	Healthcare	Energy	Telecoms	Agric/Food	Transport	Real Estate/Land	Finance	IT/data/	Other/ Media
Austria	X	X	x	x	X	X			x	
Bulgaria	X		x				X			
Croatia								X		
Czech Republic	X	X	x					X	x	
Denmark	X		x							
Estonia	x		x	x			x			
France	x	X	x	x	x	x	x			x
Germany	x	X	x	x	x	x	x			x
Greece										
Hungary	x	X	x	x	x	x				
Latvia			x	x	x		x			
Lithuan	x		x	x	x		x	x		
Malta	x	X	x	x						
Neths										
Poland	x	X	x	x	x	x	x			
Romania										
Spain	x	X	x	x	x	x	x	x		
Sweden										
Italy	x	X	x	x	x	x	x	x		x
Slovenia	x	X	x	x	x	x	x	x		
Canada	X			x			x		x	
Australia	X				x		x	X	x	
USA										
UK	X		x						x	

Source: various Australian Treasury, Foreign Investment Review Board, OECD, EU Investment Screening Reports, NSIA, CFIUS,

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