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The European Commission and Foreign Investment Screening in Europe

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Introduction

In March 2019, the European Union (EU) adopted the first pan-European investment screening mechanism (ISM), which entered into force in October 2020. ISMs are routinized legal processes by which governments review potentially problematic inward Foreign Direct Investment (FDI) transactions and deny entry to, or require the divestment of, investments that are deemed unacceptable, usually on the basis of national security criteria (Bauerle Danzman and Meunier 2021). With this new policy instrument, the EU has finally joined the bandwagon and added to the fast-growing and increasingly restrictive list of ISMs across the world. The EU ISM is also the first new instrument created since the EU's Common Commercial Policy (CCP) took an "assertive" geopolitical turn (European Commission 2021), especially towards China which the EU labeled in 2019 a "systemic rival".

Yet even though this new policy responds to broader patterns of contestation of unbridled globalization in advanced industrialized democracies and reflects a less 'naïve' EU approach toward the geopolitical dimension of trade and investment policy, the timing and nature of the EU ISM is puzzling in several dimensions. For one, the European Commission has been, for decades, a strong advocate of trade and investment liberalization; though investment screening is not protectionist *per se*, it could potentially be weaponized as such. Second, the Trade Directorate General (DG Trade) of the Commission had resisted for years calls by some Member States, members of the European Parliament (EP), and even some of the other Directorates General to design an ISM. Third, public contestation of trade and investment policy had grown virulently in the mid-2010s, jeopardizing the negotiation and ratification of several high-profile agreements; but the creation of a European ISM was not one of the demands emanating from the protesters. Last, and more importantly, EU economies, especially those reeling from the euro crisis, were in need of foreign capital; yet investment screening places restrictions on FDI.

In view of these puzzles, what explains the timing and nature of the EU's new ISM? This paper explores the role of the European Commission in the political genesis of this new commercial policy instrument. Understanding the forces and processes that have shaped the new instrument can yield important clues on the depth and scope of this assertive strategic reassessment. We also expect to contribute to the debate on the changing role of the Commission, to the nascent literature on the politics of investment screening, as well as to the vibrant literature on the politicization and geopoliticization of trade and investment policy (Meunier and Nicolaidis 2019).

Using process-tracing and relying on primary sources and extensive interviews with the actors involved in crafting the EU ISM, we analyze how the Commission has channeled contestation into the design of the EU Investment Screening Mechanism and used public support to 1) change the position of many Member States who were initially reluctant, when not downright opposed, to investment screening, 2) shape the ISM in a particular direction serving the long-standing goals of the Commission on protecting liberal regime in the EU and strengthen its bargaining power on international arena.

Our central argument is that, facing divergent national preferences on the desirability and nature of a potential ISM at the EU level, the Commission depoliticized the instrument and the policy-making process in order to avoid contestation. The Commission quickly settled on a modest instrument only supplementing national review and on a liberal-oriented screening framework with clear security criteria that suits DG Trade, 'free traders' Member States, and business. This purposeful depoliticization occurred through both formal processes and informal methods. In quickly assembling this new light-touch instrument, however, the Commission has left the door open for future crises stemming from holes in the initial design, following a Failing forward dynamic (Jones, Kelemen, Meunier 2016; Jones, Kelemen, Meunier 2021).

We start the paper with presenting the EU's new investment screening mechanism, including its functioning since implementation and the timeline for its adoption. We then take stock of the literature on politicization of trade and investment policy in the EU and the following ISM development to understand the European screening framework in a wider context of contestation

of trade and investment policymaking in the EU. Further on, we present our findings on the Commission's role in shaping the ISM through its formal and informal powers. In the conclusion we explore the policy significance of the new instrument for the EU's nascent FDI policy regime and longstanding commitment to trade liberalization and multilateralism.

1. The EU's investment screening mechanism and the birth of a new investment regime complex

While relatively modest in its ambitions, this novel investment screening framework provides an institutionalized instrument for cooperation between the EU and the Member States in reviewing FDI transactions that are potentially problematic for national security and public order in Europe. This section introduces the concept and practice of ISMs, presents a succinct timeline of the policy-making process that led to the adoption of the new instrument, and describes briefly the features of the EU ISM.

The EU's ISM: Light-touch instrument; institutional breakthrough

FDI is a class of investment where an investor domiciled in a foreign jurisdiction acquires a managerial stake in a business, usually defined as at least 10% of the voting power of the enterprise. The acquisition establishes 'lasting interest' and control over the affiliated company's operations, in contrast to portfolio investment, where investors do not generally expect to influence the management of the enterprise (OECD, 2008). FDI comes in two major modes of entry into the host economy: cross-border mergers and acquisitions (M&As), whereby the investor acquires existing assets, and 'greenfield investment', whereby the investor creates new facilities from the ground up in the host country. Actors involved in FDI are a mix of public and private, ranging from small family businesses to private equity firms to large publicly traded multinational corporations to state-owned enterprises.

States have long regulated which investments are allowed on their territory through a variety of policy tools, including state ownership of certain assets, foreign equity restrictions into sensitive

sectors, and investment screening mechanisms. ISMs enable governments to review and potentially reject proposed FDI transactions on the basis of predetermined criteria, usually on the basis of their expected impact on national security and public order. While some ISMs include an assessment of the net economic benefit of a transaction, most exclusively use security criteria. In the past decade, as FDI has become increasingly used as a tool of economic statecraft, the number of ISMs worldwide has grown rapidly and countries with established ISMs have drastically expanded the scope of review (Bauerle Danzman and Meunier 2021). In the EU, 11 out of the then 28 member states had some form of investment screening by 2017, but few were using them regularly (Meunier, 2014 -Divide and Conquer paper; plus cite Commission one year report here).¹ The most active were the German ISM, created in 2004, and the French ISM, created in 2006.

The EU screening framework is no 'ordinary' ISM, as we know them from domestic politics. It takes place in the unique context of the EU's compound polity, where the centralization of policy-making authority in the field of trade and investment is incomplete and coexists with enduring national sovereignty in selected areas of economic policy and in security and defence policies. As a result, the EU mechanism is not a European version of the powerful Committee on Foreign Investment in the United States (CFIUS). Instead, the EU mechanism provides a framework of minimum standards for the Member States' screening mechanisms, and of information and cooperation between them and the Commission. In addition, it provides for a complementary screen at the supranational level. While the cooperation highlighted in the Regulation is mandatory, the EU screening framework falls short of a binding, supranational mechanism.

This mechanism enables the member states and the Commission to raise concerns about specific transactions that "may threaten security or public order," mostly for investments in critical technologies and infrastructure. The features of the EU investment screening framework include the following:

¹ Austria, Denmark, Finland, France, Germany, Italy, Latvia, Lithuania, Poland, Portugal, Spain.

- It applies to any foreign direct investment, whether greenfield (involving the creation of a new company or establishment) or mergers and acquisitions (involving a transfer of ownership or assets).
- It includes an indicative list of factors to be weighed by Member States when screening transactions for their implications on national security and public order, such as effects on critical infrastructure, dual-use technologies, the security of supply of critical inputs, the ability to control information and access personal data, and freedom and pluralism of the media (Article 4).
- It imposes mandatory annual reporting requirements for Member States (Article 5).
- It directs Member States to implement transparent procedures with clear guidelines for triggering a review, to adhere to a review timeline, and to “give due consideration to the comments of the other Member States” (Article 6).
- It gives the Commission unilateral authority to issue opinions on the grounds of “security and public order” for investments that might affect a project or program of interest to the whole EU—such as Galileo and Horizon 2020 (Article 8).
- It requires Member States to inform the Commission and other Member States of some transactions and lists the information to be provided, such as ownership structure of the investor and approximate value of the investment (Article 9).
- It obliges the Commission to present a report to the EP and the Council on functioning and effectiveness of the Regulation annually, as well as authorises the Commission to submit a legislative proposal on amending the Regulation “where the report recommends [such] amendments” (Article 15).

In spite of these modest appearances, the EU’s ISM is a major institutional innovation for two reasons. One reason is static and refers to the nature of the policy-making issues involved. With this instrument, the Member States have opened up the possibility for the Commission to acquire a more real role in a domain traditionally viewed as highly sensitive and within the realm of core state powers because of its ‘institutional significance for state building’ (Genschel and Jachtenfuchs 2014, 9). While the Commission does not have any hard decisional power under the EU’s ISM, it becomes the hub of a new and sensitive policy network involving all Member States, with extensive monitoring powers. “For the first time this regulation creates some procedures for

foreign investment into the Single Market to be reviewed by entities other than the host country and for Member States to recognize that some investments may be politically problematic, but the ultimate decision to accept or reject the investment lies with the host country.” (Chan and Meunier, 2021).

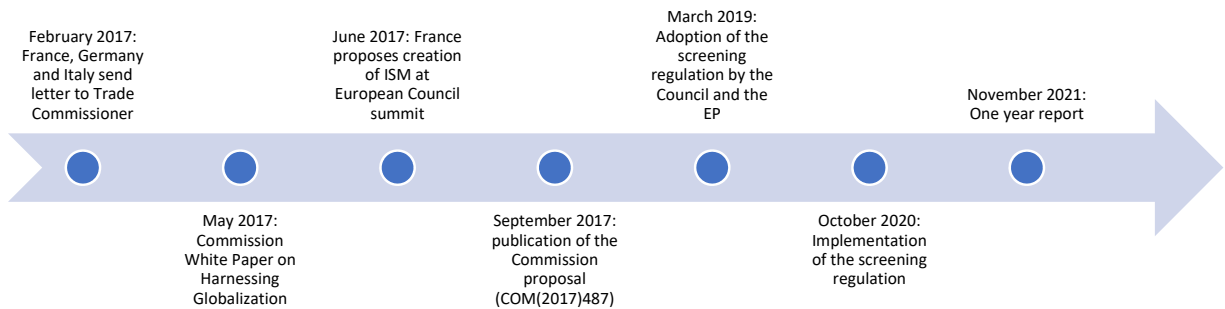
The other reason is dynamic and refers to the pivotal role of this new mechanism in the continuous EU investment regime-building. The EU’s ISM is the first step – in fact the stepping stone – towards the emergence of a significant EU investment policy regime complex involving a range of bold initiatives. Since the adoption of the investment screening mechanism in March 2019, the Commission has proposed accompanying regulation in the field of foreign subsidies, to counter the distortive effects of FDI involving EU-illegal state aid and subsidies (5 May 2021), and a widely-discussed regulation on economic coercion from third countries (8 December 2021). Furthermore, the EU has agreed on a long-in-the-making international public procurement instrument (March 2022), which is widely viewed as an important reinforcement of the EU’s emerging investment regime.

Complex issues, speedy legislation

The policy process for creating an ISM at the EU level began formally in May 2017 when the Commission issued its reflection paper ‘Harnessing the Benefits of Globalization’ in which it recognized growing concerns with foreign investors, ‘notably state-owned, taking over European companies with key technologies for strategic reasons, and that EU investors often do not enjoy the same rights to invest in the country from which the investment originates’ (European Commission 2017, 2). The drafting of a regulation creating an investment screening framework had been prompted initially by a letter from France, Germany and Italy sent to Trade Commissioner Cecilia Malmstrom in February 2017 to voice concerns about strategic foreign investments in European technology (Le Guernigou and Thomas, 2017). The momentum continued when newly elected French president Emmanuel Macron proposed the creation of a European ISM at his first European Council meeting in June 2017. In September 2017, the Commission published legislative proposal COM(2017)487 ‘establishing a framework for screening

of foreign direct investments into the European Union’, which entered the phase of amendment and decision-making in the European Parliament and the Council. The EU legislators adopted the FDI Screening Regulation (Regulation 2019/452) in March 2019 after an overwhelming vote in the EP (500 for, 49 against, and 56 abstentions) (Valero 2019). Figure 1 summarizes key moments in the policy-making process. Most notable is the speed with which the policy was elaborated and adopted. Here includes some baseline of comparison.

Figure 1: Timeline of the EU ISM policy process



To sum up, the EU investment screening framework represents a light-touch version of a ‘traditional’ ISM, where Member States preserve the ultimate decision power, whereas the Commission’s powers are limited to issuance of advisory opinions. Yet, the Commission extended its competences in regulation of FDIs, ‘opened a door’ to the security and defence policy domain, and gained an ultimate right to propose amendments to regulation to enhance efficiency of its implementation. Moreover, the approval of ISM was followed up by a chain of other policy initiatives that signify the emergence of a new investment policy regime in Europe. Finally, the establishment of the new ISM took only 18 months from proposing the legislation in September 2017 to its adoption in March 2019, which is unusually fast in the EU.

2. The Commission and the contestation of trade and investment policymaking

In order to understand the nature and causes of the EU ISM, its adoption must be placed in the wider context of the contestation of European trade and investment negotiations that had dominated the politics of trade in Europe in the mid-2010s.

The literature on the contestation of trade and investment policy: Critical junctures, ongoing debates, and blind spots

There is a broad agreement in the literature that the 1990s marked a critical juncture in the politics of trade. Two developments took place: on the one hand, the trade liberalization agenda deepened and became more comprehensive (Young & Peterson, 2006); on the other hand, non-governmental organization entered global trade politics (Graham 2000; Deslauriers and Kotshwar 2003). These developments fuelled intense waves of public contestation in the late 1990s, both around the issue of investment regulation and trade liberalization. A first global wave of public mobilization took place in 1997 against the OECD-sponsored negotiations on the Multilateral Agreement on Investment (MAI) (Meunier and Roederer-Rynning 2020). It paved the way for even more massive public mobilization against the WTO's Millenium Round, in Seattle in 1999, leading to the abort of these negotiations the same year. The next fifteen years were a period of relative calm, broken in 2013 by the negotiations of Transatlantic Trade and Investment Partnership (TTIP) between the EU and the United States of America (US). TTIP was a turning point in the politics of EU trade and investment policymaking as it mobilized a broad set of actors. The contestation of TTIP spilled over onto other EU trade agreements, for instance triggering contestation of the negotiations for the Comprehensive Economic and Trade Agreement between the EU and Canada (CETA), which had taken place until then without much public scrutiny or protest (Roederer-Rynning 2017; Meunier and Czesana, 2019). This new contestation of a policy area that until then had remained rather apolitical forced the Commission to act promptly to develop new ways of addressing the growing public concerns (Garcia-Duran, Eliasson, and Costa 2020; Young 2016).

There is a number of studies trying to explain the contestation of trade, but still relatively little consensus. The range of variables continue to encompass the changing nature of trade agreements, discontent with globalization, the role of social media, institutional change, the role of the US and foreign interference and disinformation (Meunier and Czesana 2019). Although most explanations combine several factors, one may distinguish between two broad families of explanations. Some explanations are society-centered: they focused on dynamics of interest-group mobilization among

business and non-business actors. Young (2016), for example, explains the unusual politics of TTIP with the extensive level of cross-investment between the EU and the US firms leading to establishment of alliances lobbying for harmonization of regulatory standards, and the particular TTIP focus on non-tariff barriers and regulatory differences, leading to fuelled concerns of civic interest groups, who in their turn mobilized wider public. De Bièvre and Poletti (2020) likewise argue in favor of a society-centered explanation combining structural conditions and interest group agency. Other explanations are more state-centered. For example, Meunier and Roederer-Rynning (2020), in light of cross-national variations in the pattern of TTIP politicization in Europe, emphasize the importance of political entrepreneurship at the governmental level in shaping public attention to trade and investment negotiations. Most explanations (including those), however, rely on a combination of variables.

In the field of investment regulation, most of the literature has focused on investment protection and the controversy around the TTIP's investor-state dispute settlement mechanism (ISDS). The negotiations of investment chapters in free trade agreements became possible after the inclusion of foreign direct investment policy into the CCP by the 2009 Treaty of Lisbon (Meunier 2017). While international trade policymaking traditionally used to be a matter of concern to institutional actors and economic lobbying groups, EU investment policymaking used to attract even less interest from civil society and, remarkably, business actors before the TTIP negotiations (Basedow 2016). The TTIP broke with this pattern by drawing the attention of both firms and the wider public to the negotiations of investment chapters (Basedow 2016; Young 2016). The ISDS was one of the most contested issues during the TTIP – and further CETA – negotiations, the wider public seeing it as empowering international business at the expense of governments and shrinking the political space for social regulation (Young 2016). The unusually high lobbying activity of the business community was ascribed to the strength of preexisting trans-Atlantic alliances based on substantial cross-investments between the EU and the US (Young 2016) or the Commission's entrepreneurship on shaping business interests and mobilizing business actors to gain support in the light of a wide societal opposition to the TTIP (Basedow 2019). The opposition to investment chapters forced the Commission to shift away from ad hoc arbitration to an Investment Court System, inserting this new mechanism into CETA and further agreements with Vietnam and Singapore and incorporating it into

the new trade strategy (Young 2019). Yet, we know little about long-standing implications of contestation of the investment liberalization on the wider investment policy regime in Europe.

An embattled Commission: Two fronts of contestation and Commission response strategies

The Commission has been involved in the contestation of trade and investment policy on two main fronts. On the one hand, the Commission has been involved on the institutional front, in the battle of competences with the member states. Public opposition to ISDS took place in a wider context of the debate between the Commission and the Member States on the scope and extent of the EU competence in international investment policymaking ever since the Treaty of Lisbon (Schill 2019, Young 2019). For several decades before the Treaty of Lisbon, the Commission attempted to gain wider competences in international investment policymaking to represent the Member States with a single voice in integrational trade and investment negotiations (Basedow 2016; 2019; Meunier 2017). Basedow (2016), for instance, finds that the Commission promoted the EU involvement into the international FDI negotiations and gradually pushed for the extension of the EU competences in this policy domain by using different strategies, including agenda setting, embracing and pointing to 'legal fringe' competences, to shape the preferences of the Member States and consolidate the EU's role in the policy domains beyond the CCP. Meunier (2017) argues that transfer of the competence on investment policymaking to the EU level 'occurred by stealth as a result of Commission entrepreneurship and historical serendipity' (p. 594) against the preferences of the Member States, thus highlighting the entrepreneurial role of the Commission in such a competence shift.

Since FDI was subsumed under the CCP, in Lisbon, there have been ongoing disagreements between the Commission and the Members States over the competences in international investment policymaking, which led to the adoption of the Opinion 2/15 by the Court of Justice of the European Union (CJEU) (Young 2019; Schill 2019). CJEU clarified that, while FDI constitute the exclusive competence of the EU as part of Common and Commercial Policy, investment protection on the other hand (along with the portfolio investments) remains under the shared competence of the EU and the Member States. This implied that the agreements covering both FDI and ISDS must be concluded as mixed agreements requiring individual member state ratification in addition to Council

and European Parliament ratification, thus making the negotiations process more cumbersome and the outcome more uncertain (Schill 2019; Young 2019).

On the other hand, the Commission has been involved willy nilly in the geopoliticization of trade and the globalization backlash around the liberal democracies (Meunier and Nicolaidis 2019). Scholars have connected the rise of Chinese FDI to a wave of tightening FDI policies worldwide due to concerns on transfer of technologies without reciprocity, espionage or political dependence, thus, increasing the blurriness between the politics of economy and national security (Canes-Wrone, Mattioli and Meunier 2020; Meunier and Bauerle Danzman 2021). In response to contestation, the Commission asserted the need to rethink and justify 'who these policies are for' (cite Commission strategy 'Trade for All') and further called for a 'modernization' of trade, competition, and investment policies to make them better fit the changing global realities and societal expectations (cite European Commission's 2017 reflection paper on Harnessing the Benefits of Globalization).

The scholarship has mostly emphasized the discursive dimension of the Commission's response: there is here an emerging consensus that shifts in discourses and policy ideas have fallen short of challenging the core values of the free-trade paradigm (Young 2019, Garcia-Duran, Eliasson and Costa 2020; De Ville and Siles-Brügge 2018). Young (2019) argues that the 'Trade for All' strategy represents a continuity with the previous trade policy-making practices of the Commission. Garcia-Duran, Eliasson and Costa (2020) point out the emergence of a broader doctrine of 'Managed globalization', subordinating 'trade policy to a variety of non-trade objectives, such as multilateralism, social justice, and sustainable development' (Garcia-Duran, Eliasson, and Costa 2020, 293). However, this doctrine does not challenge the fundamentals of the free-trade paradigm. Rather, the Commission has introduced elements of alternative trade paradigms *to protect the dominating 'free trade' paradigm* (De Ville and Siles-Brügge 2018).

Beyond discursive strategies, the Commission seems to have played an entrepreneurial role in the policy-making process to counterbalance public contestation. Basedow (2019), for example, mentions that the Commission might have mobilized business groups to gain support on the issue

of ISDS to counterbalance *the wide opposition* from NGOs, trade unions and media. Young (2019) points out that in response to contestation of the EU competences in investment policy the Commission changed its practice from negotiating investment issues as a part of comprehensive trade agreements to negotiating investment agreements separately. In a similar vein, Schill (2019) has argued that the EU ISM may paradoxically serve to increase the EU's bargaining power in relations with big economies such as US and China and, thus, can help the Commission pursue its long-standing constitutional goals on achieving investment liberalization. Such an argument would be consistent with international studies on investment screening policies beyond the EU, which suggest that institutional actors often respond to public contestation of markets liberalization with new market constraints or increased state regulation of cross-border capital flows (Lenihan 2018; Canes-Wrone, Mattioli and Meunier 2020; Kang 1997).

Because of its novelty, however, the investment screening at the EU level has not been much studied yet and the preliminary hypotheses which have been advanced do not focus on the role of the Commission.

To sum up, the literature on the EU trade and investment policy development tells us that: (i) the Commission has taken ongoing efforts to gain broader competences in the EU investment policymaking to promote liberalization of markets globally, (ii) these efforts took place in a hectic context of growing public opposition to trade and investment liberalization and against the wish of the Member States who contested the extension of EU powers in regulation of foreign investments, (iii) the Commission has responded to the contestation with invoking (relatively) new discourses to protect the dominating free trade paradigm, (iv) in this contested environment, ISM could paradoxically serve to increase the Commission's bargaining power on international arena to pursue long-standing goals on markets liberalization, and finally that (v) introducing market constraints is known as a common instrument used by institutional actors to address public contestation and promote their own goals. Yet, the literature falls short of explaining the nature of the EU ISM, the role of the Commission in shaping the EU ISM, and its significance for the emerging investment policy regime in Europe. In the next sections, we conceptualize the Commission as a potentially autonomous actor and show how, through formal and informal

strategies, it depoliticized the issue of investment screening and funnelled potentially divergent ISM projects into a liberal-oriented investment screening framework apt to win the support of the Member States, the EP, and the business community.

3. The Commission as a 'potentially autonomous' actor

We conceptualise the Commission as a 'potentially autonomous actor' (Evans et al. 1985). Drawing on comparative political economy and the institutionalist literature on the EU Commission (Evans et al. 1985; Nugent and Rhinard 2016, 2019), we argue that the Commission is capable of formulating and pursuing policy goals in relative independence of its environment and that, under some circumstances, it can achieve these goals.

The Commission as an actor

The Commission possess a number of features that explain why and how it is able to act independently of its environment. These features include:

- *Its structural position* at the intersection between European and global politics, which gives the Commission access to variegated flow of information, exposes it to variety of cross-pressures and thus lessens intensity of political pressure from adverse individual societal interests
- *Organizational features* such as administrative continuity, career officials and collectivities of expertise, as well as resources through command of information networks, which enables it to develop long-term transformative strategies
- *And ideological purpose and institutional memory*, which are derived from its embeddedness in the liberal postwar international trade regime.

Through a combination of the structural, organizational and ideological features, the Commission is well positioned to act independently and develop long-term transformative strategies. This implies that the Commission, as an actor, 'does not just respond to external pressure' (Evans et al.

1985), but is well equipped and is capable of exploiting windows of opportunities at the intersection of different arenas.

The Commission as an autonomous actor

Further on, the Commission enjoys a prominent position within the ordinary legislative procedure, which enables it to shape through formal *and* informal strategies the legislative process in chosen directions (Nugent and Rhinard 2016, 2019). This legislative prominence includes:

- The exclusive right of legislative initiative which comes with right to *not* initiate legislation; and the privilege of the pen.
- The possibility to vary insulation of the agenda-setting phase through control over impact assessments and the process of public consultation
- This relative autonomy is even more pronounced in ‘foreign affairs’ where executive actors have always enjoyed degree of insulation from public scrutiny.

As a result of this prominence in the legislative process, the Commission can grow and legitimize ideas through position and discussion papers while not giving limelight to competing ideas; it can mobilize a degree of bias in the policy process, particularly in sensitive fields (like foreign affairs, security, etc) where confidentiality and discretion are valued.

The Commission’s autonomy: potential, not given

At the same time, the implied ‘actorness’ of the Commission is not fixed or given, but should be seen as variable and dependent on certain factors. Such factors include (Evans et al. 1985; Levy xxx):

- ‘historical situation’, i.e. the role of crises or conjuncture of separately patterned developments, independent strategies of organizational restructuring,
- relations to societal groups, for instance responsiveness of business, engagement of NGOs and trade unions, etc.

Our empirical argument is as follows. Calls for investment screening had arisen long before 2017. But for a long time, the Commission simply blocked them for fear of opening the door to protectionism. By 2016, this had changed as a result of a conjuncture of separately patterned developments. The Commission then set the wheels in motion on the basis of a reassessment of its strategy. The goals were roughly the same – keep as open markets as possible - but the means changed – with now a more positive assessment of ISM. Faced with an intense pressure to act and competing political agendas from a range of actors, the Commission moved to embed free-trade liberal preferences into a pan-European ISM by shaping the policy process through formal and informal powers.

4. The role of the Commission: shaping the policy process, shaping the policy stance

2016: A critical juncture

Several independent trends came together in 2016 to inflect the strategy of the Commission. These trends were: a) post-Lisbon policy debate in the Commission and the EP; b) shifts in Member States' preferences independent of the Lisbon reform; c) ideological reassessment of the Commission preferences in reflection of broader patterns of international trade and investment flows. These elements set the stage for a shift in the Commission's strategy: by mid-2017, it was no longer obstructing the idea of beefing up investment screening in Europe; it set out to formulate a proposal for regulation.

Post-Lisbon policy debate. With the new supranational competence over FDI policy gained through the 2009 Lisbon Treaty, the Commission experienced a brief internal debate about the potential creation of a European ISM in 2011. Antonio Tajani, then EU Commissioner for Industry and Entrepreneurship, and Michel Barnier, then Internal Market Commissioner, wrote a joint letter to Commission President José Manuel Barroso, warning against Europe's naïveté on foreign investment and recommending the development of a supranational body to vet FDI in the EU to make sure that non-EU investments in Europe are not "attempts to close down businesses after

having stolen all of their ‘know-how’” (European Commission, 2011). However, that proposal was quickly dismissed as “neither desirable nor feasible” by Trade Commissioner Karel DeGucht on the grounds that this would be interpreted as a protectionist move, could alienate Chinese and other investors in Europe (especially in the midst of the euro crisis), and have repercussions for European investment in China (Chan and Meunier 2021).

The Lisbon Treaty had also given greater power in trade policy, and therefore FDI policy, to the European Parliament. Some members of the EP (MEPs), concerned about the challenges triggered by the surge of Chinese FDI into Europe, formally asked the Commission and the Member States in May 2012 “to set up a body entrusted with the *ex ante* evaluation of foreign strategic investment, along the lines of the Committee on Foreign Investment in the United States (CFIUS), in order to obtain a clear picture of businesses operating and investing in the territory of the EU” (De Sarnez, 2012: 11). Once again, in January 2015, the Commission rejected the concept of investment screening at the EU level, citing its commitment to “ensuring that markets remain open” (Malmström, 2015).

Shifts in member state preferences. While the Commission steadfastly refused to take on the creation of an EU-wide ISM, some Member States changed their preferences on the issue around 2016. The direct impetus for that change came from still-surgingly flows of Chinese investment. France had a long history of economic nationalism and concern about some types of foreign investment (such as US investment in the 1960s and 1990s); it therefore welcomed Chinese investment with some suspicion and had become interested in investment screening at the EU level by 2016. Germany operated what could be characterized as a U-turn on the issue of investment screening by late 2016 after two controversial Chinese acquisition bids. Between 2008 and 2016, Germany had welcomed Chinese direct investment with open arms. Because most Chinese acquisitions happened in small and medium sized enterprises (SMEs), often family firms that had no competing takeover bids after the patriarch retired, they had taken place under the radar with no media or public spotlight (Chan and Meunier 2021). This changed in 2016 with the controversial 4.5 billion euros acquisition of Kuka, one of the world’s leading makers of advanced robotic arms, by Midea, a large Chinese appliance company. The German government did not

have the policy instruments available to block this transaction, though it clearly raised concerns about technology transfers and catch-up. An even more controversial takeover bid raised alarms in Germany a few months later when the Chinese Fujian Grand Chip company tried to acquire Aixtron, a German chipmaker. Again, the German government did not have policy instruments to prevent the transaction, though in the end it did not go through because it was blocked through the CFIUS review process because Aixtron had an American subsidiary. After these back-to-back episodes, Germany simultaneously tightened its own investment screening measures and pushed for investment screening at the EU level.

The Commission was solicited once again, with more urgency, to consider creating some kind of European ISM. In February 2017, France, Germany, and Italy publicly sent a letter to EU Trade Commissioner Cecilia Malmström to voice their concerns about “a possible sell-out of European expertise, which we are currently unable to combat with effective instruments” and to call for the creation of EU powers to screen and block foreign takeovers (Le Guernigou & Thomas 2017).

Commission’s ideological reassessment. By that point, the Commission itself had started to shift its approach to both globalization and the rise of China. For decades, DG Trade had been driven by a free-trade dogma. It pushed for opening borders abroad and for keeping EU borders open, even if other countries, chief among them China, were increasingly taking advantage of that European openness and not playing by the rules. In May 2017, the Commission released a new trade strategy in its White Paper on “Harnessing Globalization”, which suggested for the first time that it might push for a pan-European investment screening framework (European Commission 2017). At the June 2017 European Council, newly elected French president Emmanuel Macron proposed the creation of a EU-level ISM. The proposal was supported only by Germany and Italy. Instead, the Member States pushed the issue to a later date, agreeing only to the Commission’s vague wording “to analyze investments from third countries in strategic sectors, while fully respecting Member States’ competences” (Valero 2017).

The Commission’s ideological shift on globalization, China, and the ever more elusive level-playing-field in trade and investment continued throughout the summer of 2017. By the time of the

annual State of the Union speech in September 2017, then Commission president Jean-Claude Juncker was ready to declare the end of European naivete in trade and he formally announced a proposal for the creation of “a new EU framework for investment screening”, stating that “if a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed.” (Juncker 2017)

The Commission proposal to create a new EU framework for investment screening in September 2017 marked the beginning of an accelerated process for the creation of a brand new policy instrument. From the announcement of the proposal until the legislative adoption, the Commission, with DG Trade in the lead, was firmly in charge of the process. From September 2017 until December 2018 the Commission elaborates the proposal with lots of back and forth with the EP, the Member States and interest groups. In February 2019 the proposal was debated and approved in the EP in the first reading. In March 2019 the act of was adopted by Council after the EP’s first reading and got signed on the 19 of March 2019 (Regulation 2019/452). Overall, it took a record time – eighteen months to adopt the Regulation from the submission of the proposal in September 2017 to its adoption in March 2019.

Competing visions for a rethink of inward investment regulation

At the ‘dawn’ of the Regulation development, the Commission was exposed to ‘a lot of signals, a lot of views and ideas’ with a changed perception that ‘FDI is not necessarily something positive’. At the same time, the task to proceed with drafting the policy proposal on the investment screening was delivered to DG Trade, which traditionally advocated for ‘free trade’ approach – ‘a signal there should not have stanchd the whole philosophy that the EU is an open regime’. There have been several potentially divergent views on the EU investment screening framework among policymakers ‘ranging from interventionist to free traders’ (Interview Commission 20 January 2022).

Economic reciprocity. The first vision of the ISM was based on applying the principle of reciprocity and economic criteria to screening foreign investments in order to safeguard the ‘level playing field’. This approach was reflected in the initial Letter of France, Germany and Italy to the Commission (February 2017), where the signatories were “worried about the lack of reciprocity and about a possible sell-out of European expertise”, thus calling the Commission to suggest a EU-level ‘protection’ based on ‘economic criteria’ to ensure the level playing field and reciprocity (Proposal for ensuring an improved level playing field in trade and investment attached to the Letter to the Commission by France, Germany and Italy). This approach to the investment screening was supported by some MEPs as reflected in the Proposal for a Union Act submitted by 10 MEPs² from the European People’s Party in March 2017. In this proposal the MEPs empathise that the EU needs ‘an additional protection on the EU level based on economic criteria with reference to the Commission’s expertise’ and calls the Commission to propose a policy to ‘extend the scope of existing protections to strategic sectors.... [and] establish a principle of reciprocity in the EU's investment policy’ (Proposal for Union Act B[8-0000/2017] as of 20 March 2017). France was widely reported that as supporting this approach (Interview MEP 7 January 2022; Interviews: Business Association (1) 6 January 2022; MEP 7 January 2022; Business Association (2) 7 January 2022; Business Association (3) 18 January 2022; Trade Union (1) 28 January 2022).

Security and public order. Another vision of the EU ISM implied restricting screening FDIs to the issues concerning national security and public order without invoking the principle of reciprocity and economic criteria to the transactions review. This version was advocated by DG Trade and supported by some parts of the EP; it was more favoured by the northern Member States including Denmark, Sweden and Netherlands, who are traditionally seen as supporters of the liberal ‘free trade’ approach (Woolcock 2010); and was overall welcomed by business community, who “strongly reject[ed] economic viability as criteria in investment screening” (Federation of German Industries 2017: 8) and lobbied for ‘keeping things [economic and security criteria] separated’ (Federation of German Industries 2017; Business Europe 2018; Interviews: MEP 7 January 2022, Business Association (3) 18 January 2022; Commission (2) 20 January 2022). Including reciprocity as grounds for ISM was seen negatively by the liberal-minded actors because

² Weber, Caspary, Saifi, I. Winkler, Cicu, Proust, Quisthoudt-Rowohl, Reding, Schwab, Szejnfeld, European People’s Party

of fears that reciprocal screening might cause a chain of reprisals from third countries leading to negative impact on investment climate in general and concrete business activities in particular. Instead, it was argued that reciprocity could be achieved *via* other means, including trade defence mechanisms and multilateral or bilateral trade and investment agreements. FDI screening on economic grounds was seen as potentially opening doors to arbitrariness and protectionism, which could in addition lead to discrepancies between different (already existing) policies, *e.g.* EU's laws in energy sector on certification of foreign-owned / controlled companies, or in the area of mergers and acquisitions on the control of concentrations between undertakings. Strict adherence to screening FDIs on national security grounds with clear definition of the criteria for the review was seen as more 'liberal' approach to the investment screening in the EU. (Federation of German Industries 2017; Business Europe 2018; Interviews: Business Association (1) 6 January 2022; Business Association (2) 7 January 2022; MEP 7 January 2022, Business Association (3) 18 January 2022; Commission (2) 20 January 2022).

As a result, the screening criteria was one of the 'cornerstones' of the policy discussions during the trialogues and informal consultations (Interviews: MEP 7 January 2022, Commission 20 January 2022). Apart from this, discussed issues included the transparency vs confidentiality of the screening process (whether or not the EP will have access to screening details of individual investment cases), potential disagreements between the Commission and Member States on the necessity of issuing an opinion, the entry into force date and preparation period, and a wider role of the EP in the screening process (Interview Commission 20 January 2022).

The final version of the Regulation does not provide for screening FDIs neither on economic criteria, nor based on reciprocity. Instead, the Regulation limits FDI screening to potential affect on security or public order (of Member States or the EU's programmes/projects) based on an indicative list of factors including critical infrastructure and technologies, supply of critical inputs, access to sensitive information, and freedom and pluralism of the media. The role of the EP is rather limited, where it neither has access to individual investment cases, nor takes part in screening process. Instead, the Commission shall report to the EP and the Council on implementation of the Regulation annually, as well as may be invited by the EP to its responsible

committee's meetings to discuss the 'systematic issues' related to such an implementation. Overall, the final version of the Regulation reflects the approach advocated by the DG Trade, liberal-minded policy-making actors (including INTA and 'free traders' Member States) and seems to satisfy expectations to the EU-level ISM of the business community and civic interest groups (Interviews: Business Association (1) 6 January 2022; Business Association (2) 7 January 2022; MEP 7 January 2022; Business Association (3) 18 January 2022; Commission (2) 20 January 2022; Trade Union (1) 28 January 2022).

Shaping the process: formal powers

Having the almost exclusive 'formal' power to propose and draft legislation, the Commission possesses exceptional opportunities "to advance legislative proceedings in its preferred directions" (Nugent and Rhinard 2019: xx). With the case of ISM, the Commission widely used these opportunities to depoliticize the adoption process and move along with the preferred version of the ISM.

First, the Proposal for a Regulation of the EP and of the Council establishing a framework for screening of FDIs into the EU (2017/0224 (COD)) reflected the security-screening vision of the ISM advocated by liberal-oriented policymakers and particularly DG Trade. Using its exclusive powers on policy initiative and draft preparation, by proposing a draft regulation reflecting its own liberal vision of the ISM, the Commission made a first step in advancing the preferred version of the Regulation.

Second, the Proposal was submitted *without an impact assessment*, which helped to narrow down the number of stakeholders involved into the policymaking process, and to speed up the adoption procedure. This is an exceptional move in the policy process (European Parliament 2018). The Commission justified the decision to skip the impact assessment by 'the rapidly changing economic reality [and] growing concerns of citizens and Member States' (the Commission 2017: 10). In terms of stakeholder consultations, the Proposal mentions that the Commission "conducted consultations with Member States that have been actively seeking an EU intervention in this policy

area, and also some other Member States, irrespective whether they maintain or not national investment screening mechanisms” (European Commission 2017, p.9-10). Also, the Commission held a public consultation from September to December 2017, however it appeared to be very limited resulting in only three feedbacks from business organizations³ (European Parliament 2018; European Commission 2017 [public consultations page]).

Finally, the policy adoption process was exceptionally rapid, where it took only eighteen months from the policy proposal to the Regulation adoption. From February to September 2017 the Commission had short internal discussion on whether to propose a full EU-level screening mechanism based on CFIUS model, or ‘start’ with a light version with a general framework leaving the decision-making powers on clearing or blocking cross-border transactions within the Member States’ competence. The Commission quite quickly reached an internal consensus that it will not move forward with the ‘full screening’ model because of 1) absence of the necessary expertise, which in case of a CFIUS model would require substantial investments into developing required competences; and – most importantly – 2) desire to avoid a risk of political contestation of the policy from the Member States at that stage. Another goal to pursue was ensuring that ‘the whole philosophy that the EU is an open regime’ would be preserved (Interview Commission 20 January 2022). It was important for the Commission to ‘get on board’ the ‘free traders’ camp of the Member States and interest groups. The overall task was to find a lowest common denominator that would address the security concerns, yet preserve the liberal investment regime, and would not lead to a strong opposition from the Member States.

The discussions in trialogues were very short as well and took place around July 2018 to autumn 2018 (European Parliament 2022 [legislative observatory]; Borderlex calendar 2018; Interview Commission 20 January 2022). Reaching a compromise with the Member States in the shortest possible terms was in part dictated by the upcoming EP elections scheduled for May 2019. The Commission invested substantial efforts into establishing a wide consensus within then acting EP, and it was necessary to complete the adoption procedures while the supporting EP was still in

³ The Federation of German Industries (BDI), the Austrian Chamber of Commerce (WKÖ), and the Federation of European Private Port Operators and Terminals (FEPORT)

power and could help gaining the votes of those Member States who were reluctant, if not opposed to, creating a EU-level investment screening policy.

Resultantly, the policymaking process was organized in the shortest possible terms, with no impact assessment, limited public consultation, and with very little attention from civil society and media. Most of the discussions with the stakeholders took place on informal platforms with focus on explanatory work and outreach, and maximum engagement of support from the EP and interest groups as discussed in the next subsection.

Shaping the regulation: powers of persuasion

While drafting the policy proposal gave the Commission a chance to shape the text in the preferred direction, the next step was to persuade those actors who held divergent views on how the ISM should look like. Here, the Commission used its informal powers, including framing and mobilization of support from different actors via informal consultations.

First, the Commission actively cooperated with liberal-minded MEPs and gained support in the Committee on International Trade (INTA). A representative of the Commission was ‘almost camping’ in the EP. The representative held ongoing discussions with MEPs, collected different views on the ISM for the Commission’s consideration, delivered back the Commission’s response, and so on (Interview Commission 20 January 2022). Liberal-minded MEPs were engaged into informal consultations too, talking to various stakeholders, including representatives of the Member States and business, and pushing forward the ‘free traders’ version of the regulation (Interview MEP 7 January 2022).

Second, the Commission organised a massive outreach and explanation campaign across interest groups. While the formal stakeholder consultation resulted in only three official feedbacks, an informal campaign covered much broader set of actors who were active in delivering their considerations to the Commission (Interview Commission 20 January 2022, Interview Business Association (3) 18 January 2022; Interview Trade Union (1) 28 January 2022). Trade unions overall welcomed the initiative. They saw it as a positive development in terms of protecting workers

rights and ‘preserving social dialogues’ by foreign investors entering the EU. The business community raised concerns on 1) administrative burden with additional filing and time constraints, 2) confidentiality, and 3) ensuring the clear and transparent security screening criteria. (Wernicke 2021; Interviews: Business Association (3) 18 January 2022; Commission 20 January 2022). To win the interest groups support and get them ‘on board’, except limiting the screening to security grounds, the Commission empathised (and advocated): 1) provisions on confidentiality commitments, 2) excluding the EP from the screening process, 3) tight deadlines for the transactions review (35 calendar days following the information receipt for the Commission’s opinion plus addition 15 calendar days for the opinion following comments of Member States), and 4) no need for additional filing from the participants to the transaction (where the filing is done at the hosting Member State level), and 5) stipulating a clear (though not exhaustive) list of factors for the considerations of national security or public order. To make sure that business community is open and supportive towards the new policy proposal, the Commission conducted an extensive outreach and explanatory work and worked towards including a wide range of civil society actors to informal consultations. Overall, the EU-level Regulation appeared to satisfy the business community (Interviews: Business Association (1) 6 January 2022; Business Association (2) 7 January 2022, Business Association (3) 18 January 2022).

Finally, to persuade the policymakers who were opponents to the security-oriented ISM and advocated for using the ISM framework to ensure reciprocity and the level playing field, the Commission widely used legal framing in its argumentation. First, DG Trade appealed to the existing international commitments of the EU within WTO and OECD. They argued that these legal commitments allow the EU to restrict FDIs on the grounds that fall under the general security protection framework, which does not imply reciprocity or level playing field. Second, the Commission argued that the EU possesses other legal instruments to invoke reciprocity and address the level playing field, inducing availability of trade defence measures. Finally, the Commission committed to submit a proposal on foreign subsidies to address the distortions in the internal market and safeguard the level playing field with regards to the FDIs subsidised by foreign countries.⁴ By doing so the Commission separated the investments screening in sensitive

⁴ Respective policy proposal was submitted in May 2021

industries on security grounds from the competition and market distortion issues. Despite that it was 'not an easy message' for many MEPs, the Commission managed to shape the discussion within the legal framework and move forward with the security-oriented regulation: "Luckily, we had these constraints" (Interview Commission 20 January 2022).

Conclusion

In this article we explore the role of the Commission in shaping the new investment screening framework in the EU. We look at this new policy in a wider context of the Commission's response to public contestation of trade and investment liberalization and Member States' opposition to the extension of the EU powers in investment policymaking, where we see the ISM as the continuation of the Commission's efforts to strengthen its position in international trade and investment negotiations and protect the liberal regime in the EU. We demonstrate how the Commission used its formal powers (drafting and proposing legislation, rapid policy process, avoiding the impact assessment) and informal powers (policy framing, outreach and informal consultations) to depoliticize the policymaking process and move forward with the preferred security-oriented regulation aimed to favour the interests of the liberal-minded actors.

The Commission masterly navigated across policy-making actors and interest groups in the ISM adoption process. DG Trade chose a lowest common denominator with no formal screening powers for the EU and sped up the policy process to avoid opposition from Member States and depoliticize the procedure. At the same time, the Commission managed to push for the ISM based solely on national security grounds without invoking reciprocity or economic criteria for FDI screening, which corresponds to liberal-minded approach of DG Trade and the long-standing goals of the Commission on further liberalization of international investment regime. This approach, on the one hand, addressed the concerns of some Member States on critical technologies transfer and security risks, and, on the other hand, gained 'on board' the liberal-minded Member States and business community, thus ensuring the support for the Commission.

The current ISM is seen by the Commission as a ‘good start’. In May 2021 the Commission proposed a follow-up legislation on foreign subsidies to address market distortions caused by FDIs subsidised by third countries, and in December 2021 – a widely-discussed regulation on economic coercion from third countries. Furthermore, in March 2022 the Council and the EP have reached an agreement to set up the international procurement instrument to introduce measures limiting the access to open EU public procurement tenders to firms from third countries where EU companies do not enjoy a similar access. The EU moves forward with a new assertive toolbox that includes export controls, scrutiny of foreign subsidies, international procurement instrument, and anti-coercion measures – and the ISM is a part of this comprehensive set of measures.

Obviously, more developments in this policy domain might be expected in the nearest future. The COVID19 pandemic and Russia’s invasion of Ukraine revealed the importance of critical infrastructure and technologies for national security (in various sectors from energy to media) and forced the EU leaders to reconsider their approach to the common security and defence policy. The Strategic Compass for stronger EU security and defence adopted by the Council in March 2022 points out that ‘making full use of the Union’s framework and national mechanisms’ for FDIs screening ‘remains critical to identify and mitigate risks to security and public order’, that Council will ‘explore additional proposals to mitigate risks for companies which produce critical technologies and products and face non-EU acquisitions’, and that national ISMS ‘should be in place in all Member States as early as possible’ (p. 35). This call for wider employment of ISM in economic statecraft leads us to expect the ‘failing forward’ dynamics (Jones, Kelemen, Meunier 2016; Jones, Kelemen, Meunier 2021): an incomplete investment screening framework will be insufficient to address the upcoming crisis with FDI screenings motivated by geopolitical concerns of the Member States. This crisis might force Member States to reconsider the existing ISM and transfer more powers to the EU level for more efficient screening procedures, thus leading to more integration in the EU investment policy.

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