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SHOULD THE EU HARMONISE OR EVEN CENTRALISE THE CONTROL OF INWARD FDI?

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The United States has for some time operated a system that controls foreign investment that might have an impact on US strategic interests. This system is called the Committee on Foreign Investments in the US (CFIUS).

In Brussels, the European Commission is contemplating whether there should be a committee on foreign investment in the EU, a *CFIEU*, or some such other mechanism. Some feel that Europe is being naïve in its attitude to investment, a bit like the family that denies that its neighbourhood is less safe than it used to be, and defiantly keeps its front door unlocked.

The media¹ has reported that Commissioners Tajani (Enterprise) and Barnier (Internal Market) in February wrote to President Barroso calling for a discussion on whether the EU has sufficient control over foreign investment into the EU. The authors pointed out that Australia, Canada, Japan, China and Russia, and as mentioned, the United States, all have systems to control foreign investments. They also indicated that a number of EU member states – such as France, Germany, Italy, Poland and the United Kingdom – have varying degrees of control over foreign access to strategic commercial assets. For those who are interested in the relationship between industrial policy and competition, the question of whether the EU should control foreign investment is an important one.

There are two overarching objectives in addressing this issue. Firstly, it might be necessary to harmonise the various approaches taken by different member states, as this could fragment the integrity of the Internal Market. A second objective would be to establish a more robust foundation from which to protect European industry against harmful and anticompetitive inward investment. Other tactical objectives will be discussed later.

Considering the need for investment controls is a perfectly legitimate exercise. If major competing economies indulge

in certain industrial political practices, then the EU must understand this and determine whether it too should adopt policies that, at a minimum, keep the playing field level.

However, it is also understandable that the initiation of this debate is worrisome for some, and particularly for those in Europe who hope the EU will lead by example in keeping the Single Market open to foreign investment and trade. It is harder for the EU to argue that other economies should open up to foreign investment, when the EU itself is establishing new controls on inward investment.

Commission officials acknowledge that the question is being discussed in the College, and there may be lively engagement in the debate. Commissioner Almunia, in a speech to the International Competition Law Forum in April this year,² indicated his position on the matter: “Our goal should be disseminating our open model and principles, not importing practices and instruments that are typical of non-market economies.” This was in the context of using EU merger clearance as a tool to block foreign investment. He indicated that he was interested in assessing the effect of state control of an acquiring entity on competition, but that the nationality of the company, or the fact that it could be state owned, should not *per se* prejudice the assessment.

Trade Commissioner Karel De Gucht also advocates for an open policy regarding foreign investment in Europe. In a December speech at the Peterson Institute for International Economics in Washington DC, he said: “The legal investment framework in the EU is one of the most open. An investor based in Ireland can operate in the whole EU, foreign companies are allowed to merge with European companies and participate in our government procurement with essentially no restrictions. This open system makes the EU an attractive place to invest, to our benefit, and we must stay open.”³

De Gucht delivered that speech right after trade talks with the Canadians. The EU side made it clear that it did not expect European companies to be treated any differently from Canadian companies regarding the acquisition of Canadian firms, even in strategic sectors.⁴ Consequently, following the letter from Tajani and Barnier earlier this year, De Gucht supposedly quipped that he didn’t think the establishment of an investment control mechanism would happen any time soon.⁵ And at a time when DG Trade is keen to test out new powers under the Lisbon Treaty to negotiate investment treaties, it would be hard to imagine the Trade Commissioner rooting for measures to restrict investment into Europe.

DG ECFIN too may worry about sending signals out of the EU that investment into the Single Market could soon be subject to stricter controls. Given the current economic malaise, there is stiff competition for cash investments. For many parts of the EU, attracting foreign direct investment (FDI) is going to be vitally important for recovery from the credit crunch and sovereign debt crises.

Other DGs should also be interested in this discussion. For example, DG Employment will want to ensure that FDI serves to promote good employment and growth opportunities in Europe, and DG Research will be determined to demonstrate that the EU taxpayer’s investments in research and development enhance European competitiveness in high growth and high value-added sectors. Foreign investment in Europe should not lead to the draining away of sound jobs and technological competence to competing economies. In this respect, DG Regio is surely also engaged in the debate.

Before looking at some questions that might help us work our way through the issue, there is some additional background to consider. At the end of 2010, shortly before the advent of the now-famous letter from the two Commissioners, a Chinese company, Xinmao, dropped out of a bid to buy Draka, a Dutch cable manufacturer. There are a number of explanations for why Xinmao dropped its bid, but one that is particularly relevant to this discussion is that Commissioner Tajani let it be known that he had concerns about Xinmao’s acquisition of Draka, questioning whether the bid was really about investing in Europe, or whether it had more to do with capturing strategic technological competence to bring home to China.⁶ It should be noted that people close to the deal (including in China), are not in agreement about whether European political intervention played a significant role in the outcome of the deal. However, even if financial and commercial factors were more important in this case, the utterance of opinions such as Commissioner Tajani’s could be viewed as an exercise of “soft” political power. Such a statement, strategically timed, can

have an influence on how financial markets react to a foreseen merger or acquisition, and hence can influence the outcome of the deal itself. Draka ultimately went to an Italian company, Prysmian, and it is very difficult to know whether political and diplomatic pressure played a role in facilitating that outcome.

DG Enterprise, which plays a key role in setting the direction of the EU’s industrial policy, (and indeed must consider the question of whether the EU should have an industrial policy or not) is currently examining the question of whether the EU has an adequately equipped toolbox to manage foreign investments. In tackling this complicated task, DG Enterprise could consider the following questions:

Who is EU? If the EU is going to start controlling, or harmonising the control of, foreign acquisitions of EU companies, be they national or *Societas Europea*, it might need

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to determine, for the specific purpose of investment control, whether it needs a new concept of what an EU company is. This can be tricky both legally and politically. The question has already been touched upon in other contexts, such as which companies can participate in EU-funded collaborative research projects, but in the context of investment control there may be other considerations to take into account.

Twenty-one years ago, the political economist Robert Reich, who was later to become President Clinton’s Secretary of Labor, wrote a paper in the *Harvard Business Review* called “Who Is Us?”⁷ Much-discussed in Washington policy circles at the time, it posited the notion that just because a company was headquartered in the United States with primarily US ownership, it did not necessarily act to support US political and economic national interests more than a foreign-controlled company that had invested in America. In this context, he discussed CFIUS and other measures designed to police foreign investment in the US. “These policies make little sense – in fact they are counterproductive. Our primary concern should be the training and development of the American workforce, not the protection of the American-owned corporation.”⁸ In his article, Reich pointed to numerous examples where Japanese and European companies were doing more to promote US industrial competitiveness than various American companies. He argued that the nationality of the company was not as relevant as the choices a company made about location of research and high value-added manufacturing facilities.

Reich does have a caveat to this view, however. He asked: “should we simply entrust our national competitiveness to any corporation that employs Americans, regardless of the nationality or corporate ownership?” “Not entirely,” he concludes.⁹ As is a concern today in the EU, Reich points

out that some foreign-owned corporations are closely tied to national economic development, either through direct public ownership, (and here he cited Airbus as an example) or through financial intermediaries. So where the object of a corporation is to enhance the wealth of its nation, rather than the enrichment of shareholders, he appears to have reservations about a uniform open-door policy.

Two decades later in Brussels, the question of states or shareholders controlling companies is an important issue that DG Competition is grappling with. However, as referenced above when Commissioner Almunia addressed the issue at St. Gallen, it is not the fact that a foreign enterprise is state-owned that is central, it is rather how the enterprise behaves as a consequence of state ownership.

We know from the commissioner's statement announcing the acquisition of Elkem by China National Bluestar¹⁰ that the commission is examining possible co-ordination by the Chinese state of market behaviour of Chinese state-owned companies in the same sector. In other words, are all state-owned companies within one sector acting as one? Even if this is the case, the commissioner spelled out that the central question is whether this impedes the ability of European consumers to enjoy sufficient competition from other players serving the market. It is noteworthy that the merger was approved and that European competition law was applied in terms of safeguarding competition within the internal market. It is equally important to note that the commissioner indicated that the behaviour of European state-owned enterprises is also examined by DG Competition.

The commission needs to consider very carefully how it tackles the question of corporate nationality when considering if and how to harmonise or centralise control of foreign investment into the EU. Reich, and apparently also Almunia, are more interested in assessing behaviour of the acquiring entity, rather than the flag it carries at the time of acquisition. As DG Enterprise addresses this matter from an industrial-policy perspective, it must assess the relevance of the "Who is Us" question from an EU perspective.

The Objectives of Foreign Investment Control. In the United States, CFIUS is primarily directed at safeguarding national-security interests. In Europe, discussants give a nod to this objective, but also lend considerable weight to a number of other concerns:

- Is the financing of acquisitions occurring on a level playing field? More precisely, are European companies up

against foreign companies (whether state-owned or not) that benefit directly or indirectly from state-subsidised financing?

- What is the risk that important intellectual property, together with high-value employment opportunities, will be drained out of the Single Market if European enterprises cannot compete fairly with foreign enterprises for investment in European assets?

Despite anecdotal evidence, more needs to be done in order to determine the level and role that state financing plays in the recent acquisitions from beyond the EU. As to the second point, we should seek to understand whether it is just foreign-controlled companies that are taking good jobs and intellectual property out of Europe, or whether European companies are doing it too. If so, what policies should be put in place to reverse the trend: investment control, or developing a more

competitive landscape for stimulating innovation, commercialising it, and retaining the talent that developed it in the EU? And where Europe has established competitive centres or clusters of innovative excellence, it may just be a question of time – if it has not happened already – that foreign investors will learn not to move or tamper with them too much and risk losing the value in their investments. Volvo and Jaguar/Land Rover might

be interesting cases where investors from BRIC economies are demonstrating that they are not simply interested in pillaging European brands and technology.

For some time American and European companies have known, and Indian and Chinese enterprises are no doubt concluding, that creativity and innovation are not so easily transplanted. Those who have come to this realisation will probably offer the right sort of productive and sustainable investment that Europe needs and will wish to compete for. It is crucial that uncompetitive operators who are not themselves acquisition targets are denied the opportunity to abuse any new EU investment-control mechanisms with which they can attempt to block competitive foreign investors from entering the market.

Soft law versus hard law? The commission is also evaluating existing mechanisms that may be used to deter undesirable foreign investment. Policymakers are talking about "soft power" or "soft law" approaches with regard to investment control. They mention assessing whether competition policy tools, trade-defence instruments, or research and innovation policy could be more actively applied to this end, instead of, or in addition to, establishing purpose-made instruments to control investment.

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Yet a "soft power" approach, if not managed well, could introduce a hefty element of arbitrariness and legal uncertainty into the environment, and this could deter the sort of investment that the EU is eager to attract. Moreover, using policy tools for purposes other than those for which they were originally intended raises important questions about political legitimacy. In doing this, one runs the risk of establishing *de facto* policies that have not been properly considered and decided on by the EU's democratic institutions. At the very least, should existing tools be cobbled together to construct a sort of patchwork investment-control apparatus, then the European Parliament and the Council will hopefully have some influence in whether and how this takes form.

Will the EU develop a Strategic Sectors list? This too can be a difficult exercise for policymakers, and the subject of lengthy debate and political wrangling. The length of the list can vary considerably from country to country, even when the purported object of the lists is to provide a basis for control over investment in specific technologies for "national security" purposes.

Because the room for defining the scope of "national security" is so broad, the term offers an immensely useful shield behind which to hide protectionism. It is all too easy to sneak sectors that are deemed important for national economic development onto "national security" lists. This practice exposes a country to the risk of prolonged and systematic distortion of competition via institutionalised protectionism.

Notwithstanding this, there are some national administrations that are rigorous and disciplined in their approach to defining and administering their Strategic Sectors lists. The OECD provides a useful forum for exchange of information and best practice in relation to management of investment measures. In deliberating on the adequacy of the EU's investment-control toolbox, DG Enterprise is no doubt closely tracking the "Freedom of Investment" (FOI) process, managed under the auspices of the OECD Investment Committee.¹¹

A question that will be voiced with increasing volume in the coming days is whether DG Enterprise is considering the establishment of a Strategic Sectors list. If so, there will be much interest in influencing the methodology for deriving such a list, and determining how it is to be used.

Conclusion

The task for the commission in defining an investment-control strategy for the EU is not easy. An assessment is underway, and preliminary findings about the adequacy of the EU's toolbox might be issued within the next couple of months, or even weeks.

Without trying to prejudice the outcome of this difficult task, the advice from this former industrial-policy analyst is: take the time needed to do a thorough job. This opinion editorial has very superficially scraped the surface of a few questions that are germane to this topic. Well-qualified experts in the commission have been looking at the matter for several months, if not longer, but a reflection period lasting several years is probably necessary to do the question justice. Part of the challenge is that other economies, other competing economies, are adapting their investment-control strategies frequently and significantly to adjust to turbulent times, and this makes it difficult to know whether the global trend is towards liberalisation or an increase in restricting measures. It would be ironic, and not a little unfortunate, if these competing economies are getting in the mood for liberalisation, inspired by the European Union and other open economies, just when the EU takes a step in the opposite direction. ■

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Footnotes

- 1 For example, John W. Miller, "EU Mulls Board to Review Foreign Investments," Wall Street Journal, 14 March 2011.
- 2 Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, "Recent developments and future priorities in EU competition policy," Speech, International Competition Policy Law Forum, St. Gallen, 8 April 2011.
- 3 Karel De Gucht, European Commissioner for Trade, "The International Trade and Investment Policy of the EU in the Next Decade," Speech, Peterson Institute for International Economics, Washington DC, 16 December 2010.
- 4 Campbell Clark, "Europeans put spotlight on Ottawa's investment restrictions," Globe and Mail, 15 December 2010.
- 5 Juliane von Reppert-Bismarck, "Rising foreign investment fuels EU vetting debate," Reuters, 9 March 2011.

- 6 Foo Yun Chee, "Interview – EU Industry Chief worried about Xinmao's Draka bid," Reuters, 2 December 2010.
- 7 Robert B. Reich, "Who is Us?," Harvard Business Review, January/February 1990.
- 8 Ibid., p. 11.
- 9 Ibid., p. 8.
- 10 Commission Press Release, IP/11/394, "Mergers: Commission clears acquisition of Norwegian company Elkem by China National Bluestar," 1 April 2011.
- 11 For the latest status report assessing investment measures of 50 participating economies, see FOI's report prepared for the 14th Roundtable on Freedom of Investment: "Inventory of Investment Measures taken between 16 September 2010 and 15 February 2011," April 2011.