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The EU's FDI Screening Proposal – Can It Really Work?

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Nowadays China and EU share close investment relations. However, concerns have been raised over FDIs (Foreign Direct Investments) aimed at sensitive sectors, especially those from Chinese state-owned companies. In light of this, the European Commission in late 2017 proposed a FDI Screening Regulation. This proposal contains certain features, including cooperation mechanisms between Member States and the Commission to notify and give comments on FDIs, direct monitoring of FDIs by the Commission on the grounds of Union interests, and the illustration of instances to be considered when screening FDIs. However, the success of this proposal is in doubt. Its fate regarding being adopted as law through the EU's legislative process is uncertain, due to the Member States' divided attitude towards FDI screening. Its provision contains a lethal loophole, undermining the cooperation and exchange of information between the Member States and the Commission. The non-binding nature of the opinions and comments addressed to the FDI receiving Member State renders the mechanisms practically unenforceable. To establish an effective FDI screening framework for the EU, this proposal needs to be revised and amended.

1. Introduction

With its continuous and steady economic growth, China has become one of the world's leading capital exporting countries. In particular, China and the European Union (EU) have shared a close investment relation in recent years. The share of Chinese investment in EU inwards foreign direct investment (FDI) has increased from 0.3% in 1995 to 2% in 2015, rendering China the sixth largest foreign investor in the EU (following the United States, Switzerland, Canada, Japan, and Brazil; European Commission 2017a, 3). In 2016, Chinese investments into EU peaked at €35 billion (EUobserver 2017a). Nowadays thousands of European companies are owned and controlled by Chinese investors (European Commission 2017a, 4). However, taking over of European firms in certain areas

by Chinese funds (such as the acquisition of leading German robot-maker, Kuka, by the Chinese company Midea) has given rise to concerns that public interests and security might be exposed to threats (EUobserver 2017b). In 2017, Jean-Claude Junker, the then President of the European Commission (the Commission), stated publicly 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 with transparency, with scrutiny, and debate.' He further added that it was a 'political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed' (EUobserver 2017c). In this context, the Commission in September 2017 presented a proposal on the Regulation concerning screening FDI into the EU (FDI Screening Regulation) (European Commission 2017b). This article aims to examine the potential successfulness and effectiveness of the FDI Screening Regulation. The second part will briefly discuss the features of the screening mechanisms under the proposed regulation. The third part will analyse the problems that might arise under the proposal. The final part concludes.

2. Features of the Proposed FDI Screening Regulation

The proposed FDI Screening Regulation is designed to provide a tool for the Commission at the EU level as well as for the Member States at national level. It is expected that, with the screening framework established under the regulation, both the EU and its Member States can respond properly and adequately to planned foreign investments, in particular from Chinese state-owned companies, in sectors that are deemed sensitive or crucial to the security and public interest of the EU and its Member States. To achieve such goals, the Regulation contains certain features, which are discussed below.

2.1. The Reaffirmation of Competence of the EU and its Member States to Monitor FDI in Harmony

Monitoring of FDI is by no means a newly created idea. Article 1 of the proposed FDI Screening Regulation confirms the power of the EU as well as its Member States to screen FDI.[1] At the national level, fewer than half of the EU Member States (Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, the UK) have implemented certain types of FDI screening mechanisms (European Commission 2017a, 7). As a result, this Regulation could in theory serve the inherent purpose of harmonizing the various national mechanisms that already are in place. It could also encourage Member States not having FDI screening mechanisms to adopt one that is consistent with this Regulation. Such intention is evidenced in Article 3 of the proposed FDI Screening Regulation, which states that

1. 'This Regulation establishes a framework for the screening by the Member States and the Commission of foreign direct investment in the Union on the grounds of security or public order.' FDI Screening Regulation, art.1. Note that the text of the articles refers to those contained in the Commission's proposal.

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'Member States may maintain, amend or adopt mechanisms to screen foreign direct investments on the grounds of security or public order, under the conditions and in accordance with the terms set out in this Regulation' (FDI Screening Regulation, art. 3.1).

At the EU level, since FDI falls within the scope of the common commercial policy, and in accordance with Articles 3(1)(e) and 207(1) of the Treaty on the Functioning of the European Union (TFEU) (European Commission 2017b, 2), the EU has the competence to directly monitor FDI. It is reaffirmed by Article 3 of this Regulation that '[t]he Commission may screen foreign direct investments that are likely to affect projects or programmes of Union interests on the grounds of security or public order' (FDI Screening Regulation, art. 3.2).

2.2. The Cooperation Mechanism

Under the proposed FDI Screening Regulation, in order to notify each other about certain FDIs that may jeopardize the security or public order, a 'cooperation mechanism' is established between the Member States at national level and the Commission at the Union level. Pursuant to Article 8 of this Regulation, Member States shall inform the Commission and the other Member States of any FDIs that are being monitored in accordance with their national screening mechanisms (FDI Screening Regulation, art. 8.1). Following such notification, if a Member State considers that a particular FDI is likely to affect its security or public order, it may provide comments to the Member State where the FDI is planned or completed (FDI Screening Regulation, art. 8.2). Similarly, the Commission is also allowed to issue an opinion addressed to the Member State where a specific FDI is made, if the Commission is convinced that the security or public order of one or more Member States is in danger (FDI Screening Regulation, art. 8.3).

Furthermore, a Member State or the Commission is entitled to request necessary information with regard to a specific FDI from the Member State where such FDI is made, so that the requesting Member State or the Commission can give their respective comments or opinions based on sufficient information (FDI Screening Regulation, art. 8.4). Finally, if a particular FDI in a Member State has given rise to concerns of affecting security or public order of other Member States, and the other Member States or the Commission have given their respective comments or opinion, then the Member State where such FDI is made shall give due consideration to the addressed comments or opinion (FDI Screening Regulation, art. 8.6).

In short, the cooperation mechanism under the proposed FDI Screening Regulation enables Member States to inform and assist each other in cases where there is a potential risk that specific FDIs in one Member State might endanger the security or public order of another. The Commission is also allowed to express its concerns towards a particular FDI if it is of the opinion that a particular FDI might jeopardize the security or public order of Member States. More importantly, the comments and opinions are to be taken into consideration when the Member State screens such FDI. It is likely that a specific FDI in one Member State is

monitored jointly, not just by the designated Member State alone, but also by other Member States and the Commission. Therefore, the cooperation mechanism is described as an 'intervention mechanism in disguise' as it gives a Member State and the Commission a legitimate channel to review and intervene against FDI in another Member State (Lavranos 2018).

2.3. Direct Screening of FDI by the Commission

Under the proposed FDI Screening Regulation, in addition to the power to intervene in the cooperation mechanism, the Commission is also given the authority to directly monitor a specific FDI in a Member State if the Commission considers that such FDI is likely to affect 'projects or programmes of Union interest' (FDI Screening Regulation, art. 3.2), in which case the Commission may express its concerns by the issuance of an opinion addressed to the Member State in question (FDI Screening Regulation, art. 9.1).

The underlying consideration for granting such direct screening power to the Commission is clearly different from that concerning the cooperation mechanism. Under the cooperation mechanism, the Commission only intervenes and issues opinions if particular FDIs in one member state might affect the interest of another Member State or other Member States. In this case, it is the interests at national level that might be at stake and the Commission is assisting the Member State or States whose national security or public order might be endangered by FDI. The direct screening of FDI by the Commission is, however, aimed to protect the security or public order of the EU as a whole. In order to clarify what is of 'Union interest', the Regulation provides in its Annex an illustrative list of projects and programmes, including the 'European GNSS programmes' concerning the implementation and exploitation of the European satellite navigation systems, the 'Trans-European Networks for Transport' (TEN-T) regarding the development of the trans-European transport network, the 'Trans-European Networks for Energy' (TEN-E) regarding trans-European energy infrastructure, the 'Trans-European Networks for Telecommunications' concerning the trans-European networks in the area of telecommunications infrastructure, and the 'Horizon 2020', a gigantic research and innovation framework programme covering research activities in, among other things, areas of cutting edge technologies, such as artificial intelligence, robotics, semiconductors and cybersecurity (European Commission 2017c). As these examples demonstrate, it can be said that a project or programme is of 'Union interest' if it involves critical infrastructure or technologies, or receives large amounts of grants from the EU (FDI Screening Regulation, art. 3.3), and therefore justifies direct screening by the Commission.

To exercise its competence of direct screening, the Commission is allowed to issue an opinion to a Member State in which a FDI that might threaten Union interest is planned or completed; the Commission is also allowed to request from the Member State any information necessary for the issuance of an opinion regarding the FDI in question (FDI Screening Regulation, art. 9.1, art. 9.2). The Member State receiving

the Commission's opinion is required to take such opinion seriously into consideration; however, such opinion does not have a binding effect on the addressed Member State; the Member State could opt to deviate from the Commission's opinion, given that it communicates to the Commission an explanation as to why the opinion is not followed (FDI Screening Regulation, art. 9.5).

2.4. Illustrative List of Grounds for Screening

Under the proposed FDI Screening Regulation, both the Member States and the Commission are allowed to screen FDI on the grounds of security or public order, irrespective of which industrial sector the FDI is targeting. However, the concept of 'security' and 'public order' is broad and abstract. In order to clear doubt and avoid ambiguity, Article 4 of the Regulation provides an illustration of factors that can be taken into consideration when deciding whether a specific FDI might affect the security or public order of the Member States or the Union as a whole. Accordingly, a Member State or the Commission may consider the potential effects on:

- critical infrastructure, including energy, transport, communications, data storage, space or financial infrastructure, as well as sensitive facilities;
- critical technologies, including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, space or nuclear technology;
- the security of supply of critical inputs; or
- access to sensitive information or the ability to control sensitive information (FDI Screening Regulation, art. 4, paragraph 1).

It can be seen from the above list that special attention is paid to FDI in sensitive areas, such as energy, communications, information technology, and cybersecurity, as public interest and security at both national and Union level are profoundly involved. In addition, the issue of 'whether the foreign investor is controlled by the government of a third country' also serves as a factor to be taken into account when determining the likelihood of security or public order being affected by the FDI in question (FDI Screening Regulation, art. 4, paragraph 2). It is worth noting that under Article 4 the wording of the text suggests that the illustrated instances are independent from each other. As a result, even if a FDI does not deal with critical infrastructure, technologies, inputs, or sensitive information, it might nevertheless be monitored if the investor is under control by the government of its home country. This is clearly an attempt to tackle foreign investment by state-owned investors from specific countries, such as China.

3. Problems with the Proposed FDI Screening Regulation

By proposing the Regulation, the Commission aims to create a framework under which the Commission and the Member States can intervene and provide comments towards a specific FDI in a particular Member State if the security or public order of

the EU or other Member States are likely to be affected. However, the success of this proposal remains to be seen. There are at least three problems arising around the proposed FDI Screening Regulation. First, the Member States have different attitudes towards screening of FDI; it is unclear whether the idea of an EU-wide FDI screening framework could gather enough support from the Member States. As a result, it is doubtful whether this proposed Regulation could be approved and passed by the legislative institutions of the EU (i.e. the European Parliament and the Council) and come into effect. Second, even if the Regulation is passed and comes into effect, there is a problem concerning the implementation of the 'cooperation mechanism' under the FDI screening framework. Third, there is the enforcement problem with regard to the opinion and comment given by the commission and other member states. These problems are discussed below.

3.1. The Legislative Problem

As mentioned above, Member States of the EU have different attitudes towards FDI. This is evidenced by the fact that fewer than half of them (12 out of 28) adopt certain types of FDI screening mechanism at the national level. It is France, Germany and Italy that have been proposing an FDI screening mechanism at the EU level on top of those at national level (EUobserver 2017b). Other Member States are less keen on this issue for various reasons. For example, the 'trading nations', including the Nordic and the Benelux countries, are wary of an EU-wide investment monitoring mechanism that might threaten their traditional free-trade policy; concerns have also been raised by Sweden, the Netherlands, Malta, Portugal, Poland and the Czech Republic that such a FDI screening mechanism would be seen by non-EU countries as a sign of protectionism in a time when the EU claims to further strengthen its trade relations with the rest of the world; moreover, countries such as Greece, Portugal, Hungary and other Member States in the eastern European region are highly dependent on FDI to revive their economic performance, it is difficult to see why they would welcome a FDI screening mechanism that may potentially have restrictive effects on attracting FDI (EUobserver 2017b, 2017c). As a result, it is only reasonable to reach the conclusion that the Member States are quite divided on the issue of FDI screening at both national and Union level.

This divergence of opinions among the Member States may have a detrimental effect on the legislative process of the proposed FDI Screening Regulation. According to Articles 289 and 294 of the TFEU, the Commission can initiate the so-called 'ordinary legislative procedure' by submitting a proposal concerning a draft version of a specific legislation (i.e. a Regulation) to the European Parliament and the Council. The draft proposal will only become law if it is jointly adopted by the two institutions (TFEU, art. 289.1, art. 294.2).

The 'ordinary legislative procedure' works as follows:[2] in the first reading, the European Parliament refers the proposed legislation to a relevant Committee under

2. European Parliament, Ordinary legislative procedure, How it works. Available at http://www.europarl.europa.eu/external/html/legislativeprocedure/default_en.htm (accessed 21 August 2019).

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the Parliament, the Committee then votes by simple majority to adopt a report, the Parliament then votes in plenary by simple majority based on the Committee's report to adopt a 'Position of the European Parliament' at first reading, then refers it to the Council; the Council in its first reading can decide by a qualified majority (QM) vote to accept the Parliament's position, in which case the proposed legislation is adopted and becomes EU law; if the Council is of a different opinion, it can amend the Parliament's position and refer the proposal back to the latter for a second reading; at the Parliament's second reading, it can accept the Council's position by a simple majority vote and the proposal is adopted; if the Council's position is rejected, the legislative process is ended; the Parliament can, however, by an absolute majority vote, amend the Council's position and refer it back to the Council for the latter's second reading; the Council either accepts the Parliament's second reading position (amendments to the Council's first reading position) by QM vote, by which the proposal is adopted, or it can reject the Parliament's amendments, resulting in a 'conciliation process' undertaken jointly by members of the Parliament and Council representatives, and possibly third readings in the two institutions.

Considering that most proposals are adopted at the stage of first reading in the Council, the voting results of first readings at both the European Parliament and the Council are vital to the adoption of the FDI Screening Regulation. In order to pass the proposal in the Parliament's first reading, a simple majority is required. This means that there must be more votes in favour of the proposal than against. The number of Members of the European Parliament (MEP) is proportional to the populations of the Member States. Currently there are 751 MEPs.[3] Suppose, in the simplest scenario, that all the Member States that adopt national FDI monitoring mechanisms (i.e. Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, the UK) support the proposed Regulation, so the MEPs from those Member States will show up and vote in favour of the proposal. In this case there will be 505 votes in favour out of the total 751 votes; accordingly, the proposal might be adopted in the first reading of the European Parliament.

However, if the proposal gets enough votes and is passed in the Parliament's first reading (EUobserver 2018),[4] it then faces the QM vote in the Council's first reading. The QM is the number of votes required in the Council for a decision to be adopted when issues are being debated on the basis of Article 16 of the Treaty on European Union and Article 238 of the TFEU; on 1 November 2014, a new procedure for QM voting, the 'double majority' rule, was implemented; under this new rule, when the Council votes on a proposal by the Commission, a QM is satisfied if two conditions are met: (1) 55% of Member States vote in favour, meaning 16 out of 28 Member

3. European Parliament, MEPs. Available at http://www.europarl.europa.eu/meps/en/map.html (accessed 21 August 2019).
4. The proposal is being discussed and has the possibly to be amended with some MEPs' own proposals, as of May 2018.

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States vote for the proposal; (2) the proposal is supported by Member States representing at least 65% of the total EU population.[5] Accordingly, for the proposed FDI screening Regulation to be accepted in the Council's first reading so that it can be adopted as law, the Commission must persuade at least 16 Member States to support the idea of an EU-wide FDI screening framework, and the population of those Member States must be no less than 65% of total EU population. However, as mentioned earlier, only France, Germany and Italy publicly call for and show support for a FDI screening mechanism. Even if all the Member States implementing FDI screening mechanisms at national level advocate the proposed FDI Screening Regulation, there are only 12 of them, not to mention that, of those 12, Denmark, Poland and Portugal have raised concerns. Consequently, if the proposal reaches the Council, it is highly likely that it cannot gather the 16 votes required to satisfy one of the two conditions under the QM mechanism.

3.2. The Implementation Problem

Suppose the Commission successfully lobbies the Member States and their respective MEPs, and the proposed FDI Screening Regulation is adopted and enters into force, there is a problem with regard to the implementation of the 'cooperation mechanism' under Article 8 of the Regulation.

Under Article 8, a Member State that is screening a FDI in accordance with its national screening mechanism assumes the obligation to inform the Commission and other Member States of the said FDI (FDI Screening Regulation, art. 8.1); on the other hand, the Commission and the other Member States acquire the right to issue opinion or give comment to the Member State concerning FDIs planned or completed in the latter's territory (FDI Screening Regulation, art. 8.2, art. 8.3); in order to facilitate their issuance of opinion or provision of comment, the Commission and the other Member States also have the right to request necessary information from the Member State in question (FDI Screening Regulation, art. 8.4). This kind of information exchange gives the Commission and other Member States the opportunity to express their concerns over the potential threats posed by a particular FDI; it also allows the Member State receiving the said FDI to take those concerns into consideration when screening the FDI. As a result, under the cooperation mechanism, a FDI targeting a particular Member State is not just to be screened by the authority of that country, but also to be monitored jointly by the Commission and other Member States, given that sufficient information is duly exchanged between them.

Hence, the key to the successful implementation of the cooperation mechanism depends on the unimpeded and unreserved exchange of information about the FDI. However, Article 8.1 states that 'Member States shall inform the Commission

5. EUR-Lex, Qualified majority. Available at https://eur-lex.europa.eu/summary/glossary/qualified_majority.html (accessed 21 August 2019).

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and the other Member States of any foreign direct investment that are undergoing screening within the framework of their screening mechanisms.' Such wording only imposes the 'obligation to inform' on Member States that already have FDI screening mechanisms in place. In other words, for Member States not yet implementing any sort of FDI screening mechanisms, Article 8.1 of the Regulation would be irrelevant and not applicable. Considering that currently only 12 out of 28 Member States have some kind of FDI screening mechanisms, and that the proposed Regulation does not require Member States not having FDI screening mechanism to adopt one, Article 8.1 creates a loophole in the cooperation mechanism, by which the possibility and effectiveness of the ideal 'joint screening' of FDI could be significantly hampered.

3.3. The Enforcement Problem

There is a third problem concerning the legal effect of the opinions and comments addressed to a Member State concerning a specific FDI planned or completed in its territory. This is a common problem for both the cooperation mechanism under Article 8 and the Commission's direct screening mechanism under Article 9.

According to Article 9.1, in order to protect Union interests, the Commission can exercise its power to screen directly a FDI in a Member State by issuing an opinion about the FDI in question to that Member State (FDI Screening Regulation, art. 9.1). Article 9.5 requires the addressed Member State to take 'utmost account' of the opinion when conducting its national screening (FDI Screening Regulation, art. 9.5). However, the Commission's opinion does not have a binding effect on the addressed Member State, as the latter is not required to follow it; Article 9.5 expressly allows the addressed Member State to deviate from the Commission's opinion as long as an 'explanation' is given (FDI Screening Regulation, art. 9.5). As for the cooperation mechanism under Article 8, the addressed Member State is asked to give 'due consideration' to the comments and opinions (FDI Screening Regulation, art. 8.6); Article 8 is silent about whether the addressed Member State can opt not to follow those comments or opinions. One can reason that, at least for the opinions issued by the Commission, the last part of Article 9.5's text can be applied by analogy to Article 8.6, by which the addressed Member State is not bound by the Commission's opinion issued under the cooperation mechanism either. One can also argue that, according to the principle of '*argumentum a maiore ad minus*', since the addressed Member State can deviate from the opinion that must be taken 'utmost account of', then of course it can also opt to disobey the opinion or comment that merely needs to be given 'due consideration'. Accordingly, the opinions and comments under Articles 8 and 9 do not have any binding effect on the addressed Member State. In fact, the Commission itself admits that its opinions issued under the proposed Regulation would be of a non-binding nature (European Commission 2017b; 3).

The opinions and comments not being binding, and therefore not enforceable on the addressed Member State, is the 'Achilles heel' of the proposed Regulation. The cooperation mechanism and the Commission's power of direct screening for Union interests are designed as the two major defensive measures against hostile FDIs. The idea is to keep Member States and the Commission informed of any FDI that might affect their security or public order, and to allow the exchange of information and expression of concerns to the Member State receiving the FDI. If the addressed Member State is not required to follow the opinions or comments, then the concerns are raised in vain. If that is to be the case, the Regulation would be pointless as its purpose of protecting security and public order of the Member States and the Union simply cannot be fulfilled.

To demonstrate the absurdity, let's suppose, in a hypothetical case, an investor from a non-EU country is planning to construct and operate a coal-burning power plant in Member State A. The planned site is near the border of Member State B. The power plant, once it commences operation, is expected to produce massive air pollution, and because of the wind direction, most of the poisonous fumes will blow into Member State B and seriously endanger the health of the citizens thereof. Member State A informs Member State B of the FDI concerning the power plant, and the latter raises its concern and gives comment to the former, asking Member State A to reconsider and relocate the site of the power plant, as far away from the border of Member State B as possible. Although under Article 8.6 Member State A is required to give 'due consideration' to Member State B's comment, such comment is nevertheless non-binding on Member State A. Because it cannot find another appropriate location for the power plant, Member State A chooses not to follow Member State B's suggestion. As a result, the threat to Member State B's public health persists. In this case, the cooperation mechanism would fail to protect the public order of Member State B. The conclusion would be the same even if the Commission steps in and gives similar opinion to Member State A, as Article 9.5 expressly allows the latter to deviate from the opinion so long as its decision comes with an explanation.

To sum up, the non-binding nature of the comments and opinions addressed to the FDI receiving Member State represents the lack of enforcement of the mechanisms under the proposed FDI Screening Regulation. It renders the Regulation toothless. The function and effectiveness of the proposed Regulation are therefore in serious doubt.

4. Conclusion

The proposed FDI Screening Regulation is an ambitious attempt by the Commission to defend EU interests in light of FDIs threatening the security or public order of individual Member States or the Union as a whole. Despite its novel design, such as the exchange of information between Member States and the Commission, and

the direct screening by the Commission for Union interests, this proposal still faces several problems. The divided attitudes and standpoints of the Member States with respect to the screening of FDI make it a challenge to have the proposal passed and adopted as law, as far as the QM vote mechanism in the Council is concerned. The wording of Article 8.1 explicitly exempts Member States not having national FDI screening mechanisms from the notification obligation, significantly undermining the exchange of information under the cooperation mechanism. Finally, the non-binding nature of the opinions and comments addressed to the FDI receiving Member State renders the mechanisms practically unenforceable, resulting in a serious blow to the effectiveness of the proposed Regulation. Consequently, it will be a long way down the road that the EU's FDI screening framework and mechanisms will be established, and the Commission's proposal is definitely in need of revision and amendments.

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