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FDI screening regime of the European Union, is a way toward protectionism?

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Abstract

Foreign direct investment is undeniably one of the drivers of economic development, and as such, it has economic benefits, and functions as a catalysator for international trade and globalization. Even though its positive returns, might be reasons to be restricted, especially when the planned FDI transaction conflicts with the public order or security interest of a State. To 2017, several trading partners of the European Union already established FDI screening mechanisms or restrictive measures, what caused inequality toward the Union. Furthermore, more Member States had already introduced FDI screening rules, what caused regulatory discrepancies amongst the Member States. Therefore, although the European Union is still amongst the most open economies on earth, the creation of an FDI due diligence framework was necessary. In regard of three years after its fully applicability, the Regulation, and the operation of the FDI screening mechanisms of the Member States are worth to be reviewed. Moreover, the first FDI-related case law is emerged, where different interpretation of conceptual definitions is visible, yet the judgement of ECJ follows the previous ones. As a conclusion, the FDI screening Regulation has accomplished its two-sided goal. Firstly, it is not an unprecedented protectionism, but rather a reactive step towards third countries and secondly, it harmonizes the FDI-framework with laying down minimum rules for Member States. In addition, it fits into the framework of other EU legal instruments, such as the European Merger Regulation or the Foreign Subsidies Regulation.

1. Open economy

Economic openness means when not only the domestic factors, but also foreign entities take part in trade of products, goods, services or managerial exchange, technology transfer. Trade and market openness has historically gone together for better economic performance in countries at all levels of development, such as by creating new opportunities for workers, consumers and firms and helping to lift millions out of poverty. In the 21st century almost every country has certain degree of open economy.[1] Closed economies are on the other half of the scale, where no possibility to international trade (export, import or finance). Trade provides a revolution in the availability of goods also for

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[1] According to the Oxford Reference (https://www.oxfordreference.com/display/10.1093/oi/authority.20110803100251806) "An economy in which a significant percentage of its goods and services are traded internationally. The degree of openness of an economy usually depends on the amount of overseas trade in which the country is involved or the political policies of its government. "

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low-income households,[2] and working conditions may increase. Open economies grow faster when there is the possible to invest outside the origin country, as long as the economy establishes an open investment climate[3].

The idea of the open economy is related to the idea of globalization: what connects people, businesses (and governments) to interact across the globe. Economic openness, as everything on earth has proponents,[4] who believe that economic openness would positively impact trade and stimulate job growth and economic opportunities, and opponents,[5] who believe that it could weaken national economies due to its competitive nature and can cause more co-dependency amongst Countries and economies and this can erode unavoidable economical risks[6]. As an opponent reasoning, for example, many Europeans were apprehensive from 2017 as "they see globalization as synonymous to job losses, social injustice or low environmental, health and privacy standards. They *consider it to be a factor in the erosion of traditions and identities*".[7]

2. Foreign Direct Investments, as the term for lasting cross-border capital flow

The definition of Foreign Direct Investment (hereinafter: FDI) has developed over the decades. The World Trade Organization (hereinafter: WTO)[8] categorized FDI in 1996 as: "FDI occurs when an investor based in one country (the home country) *acquires an asset* in another country (the host country) *with the intent to manage* that asset. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds, and other financial instruments. In most instances, both the investor and the asset it manages abroad are business firms. In such cases, the investor is typically referred to as the "parent firm" and the asset as the 'affiliate' or 'subsidiary'." In 2005, The

[2] This tendency is visible by the help of tables made by Organisation for Economic Co-operation and Development (hereinafter: OECD) here: https://www.oecd.org/trade/understanding-the-global-trading-system/why-open-markets-matter/
[3] Like the European Union does it by the meaning of the European investment plan. More about this is visible here: https://www.consilium.europa.eu/en/policies/investment-plan/
[4] As such: Roberto Chang, Linda Kaltani, Norman V. Loayza in Journal of Development Economics vol.90, issue 1., September 2009 pp. 33-49. DOI: https://doi.org/10.1016/j.jdeveco.2008.06.011
[5] A rather sympathetic critique of Open Economy Politics can be readable by David A. Lake, in: Lake, D.A. Open economy politics: A critical review. *Rev Int Organ* 4, 219–244 (2009). DOI: https://doi.org/10.1007/s11558-009-9060-y
[6] According to Rudiger Dornbusch and Stanley Fisher that co-dependency amongst countries and economies can cause unavoidable economical risks. See in: Rudiger Dornbusch & Stanley Fischer, 1984. "The Open Economy: Implications for Monetary and Fiscal Policy" NBER Working Papers 1422, National Bureau of Economic Research, Inc.
[7] An interesting example can be visible in a reflection White Paper presented by the European Commission in 2017 on the Harnessing globalisation (https://commission.europa.eu/system/files/2020-07/reflection-paper-globalisation_en.pdf), according to the pp. 9.
[8] In WTO news, 1996 press release: "Trade and foreign direct investment" https://www.wto.org/english/news_e/pres96_e/pr057_e.htm

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International Monetary Fund (hereinafter: IMF) has proposed[9] a new definition: "Foreign direct investment enterprise is an enterprise (institutional unit) in the financial or non-financial corporate sectors of the economy in which a non-resident investor owns 10 per cent or more of the voting power of an incorporated enterprise or has the equivalent ownership in an enterprise operating under another legal structure."

The Organization for Economic Co-operation and Development (OECD) also developed one recent definition after the abovementioned IMF definition. „Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Ownership of 10 percent or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship. FDI is a key element in international economic integration because it creates stable and long-lasting links between economies. FDI is an important channel for the transfer of technology between countries, promotes international trade through access to foreign markets, and can be an important vehicle for economic development."

Foreign Direct Investments must be separated from Foreign (Indirect) Portfolio Investments (FPI)[10]. Indirect investments, or 'foreign portfolio investments' are when companies, financial institutions or individuals *buy stakes in companies on a stock exchange.* This type of investment is not made with the intention of acquiring a controlling interest in the issuing company. Moreover, they are generally short-term and realized to take advantage of favorable changes in exchange rates or to earn short-term profits on interest rate differences, and to diversify portfolios and better risk-management. We can distinguish two types of FDI[11]: the greenfield and brownfield investments. *Greenfield investment*s are the creation of a new company or establishment of facilities abroad, it is understandable as a form of market entry commonly used when a company wants to achieve the highest degree of control over foreign activities. While *brownfield investments* are to transfer the ownership of already existing assets (and existing company) to an owner abroad. Mergers and acquisitions (M&A transactions) are considered as brownfield investments, since, by the meaning of mergers two companies are willing to form into one, and by the meaning of acquisitions, one company is about to be taken over by another.

[9] In the Eighteenth Meeting of the IMF Committee on Balance of Payments Statistics Washington, D.C., June 27–July 1, 2005: https://www.imf.org/external/pubs/ft/bop/2005/05-58.pdf

[10] See more about the "Complementarity, differences, and Integration of Foreign portfolio investments and direct investments by Kimberly Evans in the Global Forum on international investments – Attracting foreign direct investment for development, Shanghai, 5-6 December 2002: https://www.oecd.org/investment/investmentfordevelopment/2764407.pdf

[11] According to the European Commission's Access2Markets concept: https://trade.ec.europa.eu/access-to-markets/en/content/types-investment

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Many economists measure the impact of FDI to competitiveness. Theoretically[12], if the FDI flows into a greenfield investment, then it may have a positive influence on productivity and capital accumulation by establishing the new facility and by forming new jobs. In the case of brownfield investments, which is not create a new facility, may not raise capital accumulation and productivity, however it can influence economic growth positively by the meaning of new knowledge and technology transfer. As Yilmaz Bayar[13] wrote, FDI inflows can indirectly affect the economic growth also in case of brownfield investments, not just in greenfield investments. Several studies show that undeniable, FDI is essential in international economic integration and globalization[14], since it creates long-lasting relation amongst countries, and an important channel for the transfer of technologies[15], and therefore an important vehicle for economic development. The European Commission declared this in 2015, as "EU welcomes foreign investments because of the substantial benefits they bring for our economy and society at large"[16].

International standards are developed for statistics to measure FDI in-and outward. The current international transactions reporting system is the BPM6[17] – the 6th edition of Balance of Payments and international investment position Manual. With its assistant, the transparent, country-based statistics are producible.[18] That was necessary according to

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[12] This theory is ensured generally by several authors. As such, *Eduardo Borensztein, Jose De Gregorio, Jong-Wha Lee,* 1995. "How Does Foreign Direct Investment Affect Economic Growth?," NBER Working Papers 5057, National Bureau of Economic Research, Inc., *Hong Zhuang*, 2016. "The effect of foreign direct investment on human capital development in East Asia" In Journal of the Asia Pacific Economy 22(2):1-17, DOI:10.1080/13547860.2016.1240321 , *Panagiotis Pegkas*, 2015. "The impact of FDI on economic growth in Eurozone countries" in The Journal of Economic Asymmetries, vol. 12., issue 2, 124-132. DOI: https//doi.org/10.1016/j.jeca.2015.05.001

[13] Yilmaz Bayar: Greenfield and Brownfield Investments and Economic Growth: Evidence from Central and Eastern European Union Countries, September 2017, Our economy 63(3), DOI:10.1515/ngoe-2017-0015

[14] See in: Irena Pekarskiene and Rozita Susniene: "Features of Foreign Direct Investment in the Context of Globalisation", Procedia – Social and Behavioral Sciences, vol. 213, December 2015, pp. 204-210. DOI: https://doi.org/10.1016/j.sbspro.2015.11.427

[15] Such as in the case of Kenya. In: Osano, H.M., Koine, P.W. Role of foreign direct investment on technology transfer and economic growth in Kenya: a case of the energy sector. *J Innov Entrep* 5, 31 (2016). DOI: https://doi.org/10.1186/s13731-016-0059-3

[16] This Commission declaration is visible in a Communication of Welcoming Foreign Direct Investment while Protecting Essential Interests, as such: "Foreign direct investment is a source of growth and jobs. It links EU companies with global value chains that drive the modern economy. It boosts productivity and makes our companies more competitive by improving resource allocation, bringing in capital, technologies and expertise, increasing competition, stimulating innovation, and opening new markets for EU's exports. Furthermore, it supports the objectives of the Investment Plan for Europe, and other EU projects and programs. Outward foreign direct investment generates similar gains as inward flows, including for the implementation of the 2030 Agenda for Sustainable Development. For all those reasons, the EU will continue to support liberalization and protection of investments worldwide." pp. 4 https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2017:0494: FIN:EN:PDF

[17] Companion document is reachable here: https://www.imf.org/external/pubs/ft/bop/2014/pdf/guide.pdf

[18] Like in the case of Hungary: https://statisztika.mnb.hu/statistical-topics/balance-of-payments-and-related-statistics Where searchable data is categorized by FDI income, FDI flows, by the country of the ultimate investor, etc.

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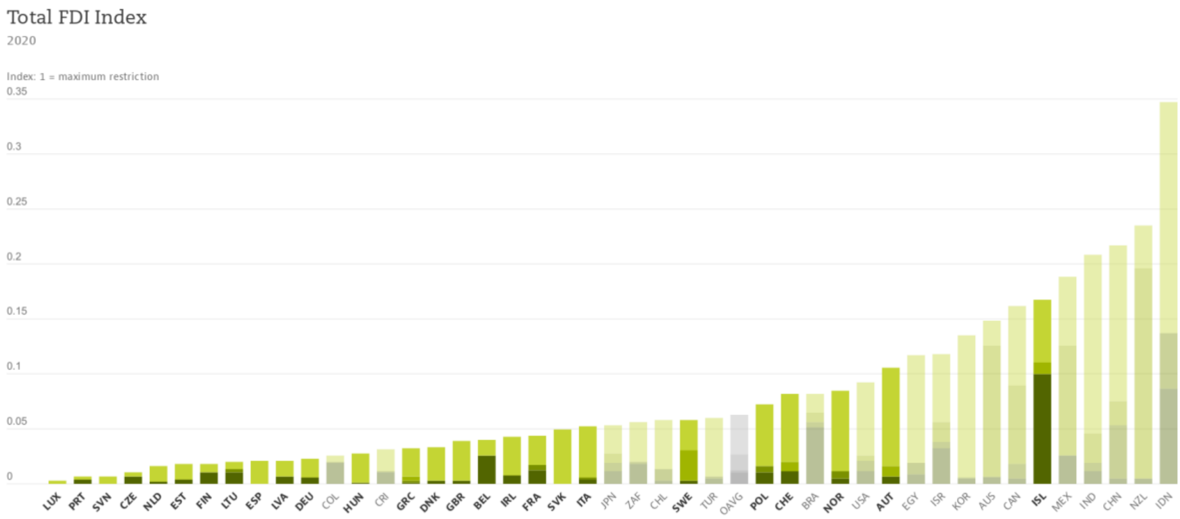
the Guide, because it "(…) summarize the economic relationships between residents of that economy and nonresidents and provide an integrated framework for the analysis of an economy's international economic relationships". International Organizations, such as OECD and World Bank Group (hereinafter: WBG) produces aggregated data on the basis on inward and outward values for stocks, flows and income, by countries and by industries, moreover, the FDI restrictiveness. With the support of the comparative export-import rates,[19] an economy can be quantifiable on how open its economy. *FDI-Regulatory restrictiveness* is a calculable, objective measure how open an economy for investment climate[20] in the meaning of its regulatory system.



FDI Restrictiveness Index according to the OECD is „not a full measure of a country's investment climate. A range of other factors come into play, including how FDI rules are implemented. Entry barriers can also arise for other reasons, including state ownership in key sectors. A country's ability to attract FDI will be affected by factors such as the size of its market, the extent of its integration with neighbors and even geography. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors. Furthermore, unlike geography, FDI rules are something over which governments have control. FDI restrictions tend to arise mostly in primary sectors such as mining, fishing, and agriculture, but also in media and transport." As it visible from the chart, *FDI regulatory restrictions were not applicable in Europe as a whole* (since the European

[19] Trade-related statistics (such as import of goods and services (in the percentage of the country's GDP) can be searchable here: https://data.worldbank.org/indicator/NE.IMP.GNFS.ZS?view=map

[20] More information about the FDI-restrictive index can be visible here: https://data.worldbank.org/indicator/NE.IMP.GNFS.ZS?view=map. However, The FDI Index measures the restrictiveness of a country's FDI rules by looking at the four main types of restrictions on FDI. And therefore, not only FDI screening mechanisms are examined under its term, but it is also one of the key factors of it. These 4 types of restrictions are the following: 1.: Foreign equity limitations, 2.: Screening or approval mechanisms, 3.: Restrictions on the employment of foreigners as key personnel, 4.: Operational restrictions, e.g., restrictions on branching and on capital repatriation or on land ownership.

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member states' regulatory restrictiveness is rather lower), *until 2019*, however until that time, almost all its commercial partners[21] have developed FDI inward regulatory system.

Nonetheless, it is visible in the following this chart:[22] the amount of FDI inflows and outflows of the EU are significant: The EU was the world's *leading source and destination* of foreign direct investment.

Global FDI inward and outward stocks (billion EUR)

	FDI inward stocks					FDI outward stocks				
Reporter	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
World	**23 954.6**	**25 744.3**	**29 404.6**	**27 895.0**	**32 577.2**	**23 952.1**	**25 388.5**	**29 247.2**	**26 678.7**	**30 880.9**
EU27	**6 679.8**	**6 717.0**	**7 841.6**	**7 331.7**	**8 033.7**	**7 965.7**	**8 146.3**	**9 231.1**	**8 530.9**	**9 490.3**
Australia	510.5	552.1	619.3	594.2	638.0	375.5	393.7	445.5	420.8	517.4
Brazil	387.4	509.1	551.5	481.6	572.3	166.7	183.6	212.1	176.5	200.0
Canada	726.7	816.2	855.7	721.6	926.4	1 042.0	1 165.4	1 356.3	1 156.8	1 476.1
China	1 099.5	1 222.9	1 318.9	1 378.7	1 580.6	989.5	1 226.3	1 601.4	1 678.5	1 875.3
Hong Kong	1 434.5	1 469.0	1 720.7	1 662.4	1 668.5	1 380.3	1 397.3	1 605.1	1 549.0	1 602.5
India	254.7	287.6	333.9	327.0	381.4	125.3	130.2	137.4	141.1	159.6
Japan	157.0	177.6	179.2	173.4	198.8	1 107.5	1 188.2	1 325.6	1 327.0	1 624.1
Malaysia	105.2	110.2	129.8	130.9	150.9	122.6	113.9	114.7	100.0	105.9
Mexico	452.5	427.7	434.3	432.9	561.4	130.4	132.1	154.9	130.0	205.8
Russia	236.8	355.9	390.5	345.6	414.4	261.5	309.7	344.1	293.5	345.4
Singapore	983.8	1 012.0	1 233.5	1 300.7	1 516.4	667.2	755.9	887.2	868.6	988.1
South Korea	161.8	170.6	203.1	200.9	213.1	257.7	280.3	319.2	343.1	393.2
Switzerland	802.6	1 013.6	1 197.3	1 146.9	1 206.5	1 019.7	1 183.3	1 273.3	1 265.6	1 363.3
Thailand	165.2	172.0	196.2	191.6	227.3	63.4	78.2	97.7	104.7	122.8
Turkey	143.3	135.5	174.8	124.7	147.3	32.2	34.9	40.6	38.0	42.7
United Arab Emirates	99.1	108.0	115.0	118.8	137.7	87.9	99.8	110.2	118.1	138.8
United Kingdom	1 379.6	1 319.6	1 598.5	1 634.6	1 853.8	1 447.0	1 416.6	1 570.0	1 514.2	1 741.4
USA	5 165.7	5 950.3	6 943.6	6 293.1	8 455.4	5 461.3	5 792.9	6 929.9	5 463.8	6 897.5
Vietnam	92.7	104.3	114.6	122.8	143.9	7.7	8.7	8.9	9.0	9.9

Coverage: including intra-EU stocks.
Source: UNCTAD.

This openness is not surprising, hence free and open market economy's principle is declared in the Article 63 and 206 of the Treaty on the Functioning of the European Union (hereinafter: TFEU) that Union's investment regime is one of the most open regimes in the world.

3. Ratio behind FDI restriction

There are several reasons why an economy wants to restrict[23] FDI by regulatory instruments. Mostly *reasoned by security interest / public order of the State*. This kind of restrictions are in accordance with the WTO Agreements (such as GATS security

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[21] European Union has several Trade Agreements globally, according to the following: https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/negotiations-and-agreements_en. Nonetheless, most of our trading partners had already had FDI screening regulation, inter alia: the USA, Canada, South-Korea, Israel, India.

[22] The Trade Statistic Guide, produced by Eurostat: https://op.europa.eu/en/publication-detail/-/publication/c6755ec7-1761-11ec-b4fe-01aa75ed71a1

[23] Restriction is a rather newer tendency emerged in the past 20 years. Before restriction, the Governments make incentives for a better and more attractive environment for inbound FDI. Many scholars wrote several analytical works about it, and the OECD has gathered several analytical works and published a compilation of them. Some of them are the following. "The Economics of International Investment Incentives", 2001, written by Prof. Magnus Blodström (https://www.oecd.org/daf/inv/investment-policy/2487874.pdf). "Policy Competition and Foreign Direct Investment", 2000, written by Charles Oman (https://www.oecd.org/mena/competitiveness/35275189.pdf). A report realized by OECD Centre for Tax Policy and Administration: "Corporate Tax Incentives for Foreign Direct Investment", 2001: https://doi.org/10.1787/19900538, Regulatory Investment Incentives, 2001, by Dr. Valpy Fitzgerald (https://www.oecd.org/daf/inv/investmentstatisticsandanalysis/2510459.pdf).

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exceptions,[24] Article XIV bis GATS). In the World Investment Report[25], realized by United Nations Conference on Trade and Development (hereinafter: UNCTAD) it was visible, that Countries remain willing for an attractive environment for FDI, but regulatory or restrictive administrative measures has increased since 2015. It means not only by emerging new legislation but also the host countries' approaches have changed in regard trade restrictions that indirectly affect foreign investors and political pressure and retention measures influencing investment decisions.

In India[26], most sectors are liberated for FDI, and there are some sectors where Government permit needs if the share is exceeded certain percentage (such as private banking and printed media), and there are sectors where FDI is totally excluded. Japan[27] also responded the growing concerns over its security and the outflow of critical technologies and in regard of the trend toward stricter FDI Regulations in the interest of global security, the government has introduced several significant amendments to the FDI Regulations (what is in effect since 2017). In the USA, in specified sectors FDI screening, and restrictions exist[28] for a long time, however in August of 2023 President Biden issued an executive order[29], which prohibits certain outbound United States investments to People's Republic of China (including Hong Kong and Macau) in several technology sectors relevant to military, intelligence, surveillance, or cyber-enabled capabilities. In the People's Republic of China[30] during the years (especially after Covid-19 pandemic) a wide range of FDI restrictions were emerged, such as more developed Cyber-security and Monitoring Authorities. FDI transactions are screened in case of sectors related to national defense and security, or in geographic locations in close proximity to military facilities or defense-related facilities, or in sectors significant for national security, such as critical agricultural

[24] According to the point of view of Martina Francesca Ferracane: "GATS security exception: What if it were to be invoked to justify restrictions on data flows?", APEC Currents, February 2019: https://www.apec.org.au/apec-currents-2019-feb-gats

[25] World Investment Report, realized by UNCITRAL in 2017: pp.99: https://unctad.org/system/files/official-document/wir2017_en.pdf

[26] More about the FDI restriction regulatory framework can be visible here, as a compilation made by practicing lawyers from India: https://globalcompetitionreview.com/guide/foreign-direct-investment-regulation-guide/second-edition/article/india

[27] More about the FDI restriction regulatory framework can be visible here, as a compilation made by practicing lawyers from Japan: https://globalcompetitionreview.com/guide/foreign-direct-investment-regulation-guide/second-edition/article/japan

[28] Limitations on Foreign Investment into the United States, realized by Edward S. Riviera: https://www.trade.gov/sites/default/files/2021-05/Chapter%206%20-%20FDI%20Restrictions.pdf

[29] President Biden issued an executive order (in August 2023) to prohibit certain outbound United States investments to People's Republic of China in several technology sectors relevant to military, intelligence, surveillance, or cyber-enabled capabilities. See more here: https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/

[30] More about the FDI restriction regulatory framework can be visible here, as a compilation made by practicing lawyers from China: https://www.whitecase.com/insight-our-thinking/foreign-direct-investment-reviews-2023-china

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products, energy and resources, equipment manufacturing, infrastructure, transportation services, cultural products and services, information technology and internet products and services, financial services, and key technologies; *if* the foreign investors obtaining "actual control" of the target enterprise. Furthermore, 'Made in China 2025[31]' strategy lists key sectors[32], where *more subsidies are granted by Government* and therefore in the respective sectors, *more takeovers of European companies are to be expected*[33].

4. The decision of the European Union

Derived from the above-mentioned, FDI restrictions were applicable throughout the globe, however in most of the European countries, there were not any existing FDI restriction until the recent years. According to the prior shown charts, the European Union was one of the most open economies world-widely, with no "united" FDI-screening mechanisms. What caused a disadvantageous situation in relation to the commercial partners with already existing FDI screening mechanisms, and vulnerability in defending its values[34]. This lack of European-wide legislation grounded the floor to the Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 'establishing a framework for the screening of foreign direct investments into the Union' (hereinafter: FDI screening Regulation), as the Preamble[35] states: "There is currently *no comprehensive framework at Union level* for the screening of foreign direct investments *on the grounds of security or public order*, while the major trading partners of the Union have already developed such frameworks." Nevertheless, pursuant to the international commitments of international (institutional, trade and investment) agreements concluded with third countries, there is the possibility for the Union and the Members States to adopt restrictive measures relating to foreign direct investment on the grounds of security or public order.

[31] More about the 'Made in China 2025' Plan is visible here: http://english.www.gov.cn/policies/latest_releases/2015/05/19/content_281475110703534.htm

[32] Key sectors are the following: next-generation IT; high-end numerical control machinery and robotics; aerospace and aviation equipment; maritime engineering equipment and high-tech maritime vessel manufacturing; advanced rail equipment; energy-saving vehicles and NEVs; electrical equipment; agricultural machinery and equipment; new materials; biomedicine and high-performance medical devices. That was the reason, why EESC recommended to enlarge the Regulation's Art. 4's list in these sectors. (According to the above-mentioned, State Council plan.)

[33] According to Zenobia T. Chan and Sophie Meunier in Chan, Z.T., Meunier, S. Behind the screen: Understanding national support for a foreign investment screening mechanism in the European Union. Rev Int Organ 17, 513–541 (2022). DOI: https://doi.org/10.1007/s11558-021-09436-y , *Point 3.2*.

[34] However, in Article 3 point 5 of the Treaty on European Union (hereinafter: TEU) declares its responsibility to fulfill this obligation, as "in its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens."

[35] See more in especially in Preamble (1), (2), (3) and (5) of the FDI screening Regulation.

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As Tamara Capeta[36] stated in 2023, "(if) I (had) received such a question 20 years ago, there would have been little doubt in my mind that it *concerned protectionism of the kind not tolerated by a free and open market economy*".[37] However, the world has changed, as every EU citizen can felt personally, whether in the form of empty supermarket shelves or higher energy bills. "Accordingly, and particularly when presented with measures that arguably represent a step backwards in the openness of the European Union's internal market vis-à-vis trade with third countries, one should not jump to conclusions too quickly: tomorrow's *strategic geopolitical interests* have the potential to influence today's commitments to free trade."[38]

This kind of protectionism is not without antecedents, it was experienced throughout the last decade. Starting with the Communication[39] from 2010, as "efforts should also be made to ensure that this rising competitive pressure from *emerging economies* is not based on growth strategies relying heavily *on protectionist measures* to promote exports and discriminate against imports. Indeed, tendencies have been observed towards the undue use of non-tariff barriers to trade, hidden subsidies, discriminatory public procurement, forced technology transfer, managed exchange rates, and poor enforcement of social and environmental protection. It is therefore essential to continue to monitor closely such state interventions that distort competition and to take appropriate action." For this reason, the EU market access strategy is an important tool with attention on foreign direct investment screening, besides public procurement, and restrictions on raw material exports.

Another Communication[40] from the Commission emerged in 2015 to create a rule-based regime for trade and investment (for introducing a more transparent trade and investment policy). Intentionally, it leads the way for the better unfold of the European values: more responsive approach to public's expectation and to promote sustainable development, human rights, and good governance. "Facilitating *trade in services* also requires openness to foreign direct investment. Over 60% of EU direct investment abroad is connected to trade in services[41]. International trade in services requires companies to establish in markets abroad to deliver services to new local customers. Investing around the world also allows service companies to offer global solutions to customers at home,

[36] As being the Advocate General in the first FDI-related case law of the European Court of Justice (hereinafter: ECJ). Case C-106/22 Xella Magyarország Építőanyagipari Kft. v. Innovációs és Technológiai Miniszter (hereinafter: Xella case). In details, see below.
[37] Xella case: Opinion of advocate general, delivered on 30 March 2023, point 3.
[38] Xella case: Opinion of advocate general, delivered on 30 March 2023, point 5.
[39] Communication from the Commission: An Integrated Industrial Policy for the Globalisation Era Putting Competitiveness and Sustainability at Centre Stage Pp. 16-17: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0614:FIN:EN:PDF
[40] Communication from the Commission: Trade for All – Towards a more responsible trade and investment policy pp. 6: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0497&rid=1
[41] The WTO estimates that two thirds of services are delivered through establishments, according to the World Trade Report 2019 realized by WTO (https://www.wto.org/english/res_e/booksp_e/00_wtr19_e.pdf)

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supporting the connections of EU manufacturing and service companies to global value chains."

Continuing with a Communication[42] from 2017, when the European Commission stated that: "Openness to foreign investment remains a key principle for the EU and a major source of growth. However, concerns have recently been voiced about foreign investors, notably *state-owned enterprises, taking over European companies with key technologies for strategic reasons*. EU investors often do not enjoy the same rights to invest in the country from which the investment originates. These concerns need careful analysis and appropriate action." Another Communication[43] was published in 2017. It declared that "to address the potential impact of cross-border takeovers on security and public order, *nearly half of EU Member States currently maintain foreign direct investment screening mechanisms* and reserve the power to restrict investments that pose a threat to their essential interests. However, despite a clear European dimension to foreign direct investment, *there is neither systematic cooperation* among Member States nor an EU-wide approach to these issues."

This Communication moreover firstly declared, that FDI screening *toward some commercial partners of the EU is crucial to ensure that everyone plays by the same rules*. Hence the Union must protect assets inside the internal market against take-overs what are disadvantages to the essential European or national interest, especially if it is realised by the assistance of a foreign government (sometimes as part of a declared government strategy[44]). As the World Investment Report[45] also cleared that the trend of State-Owned Enterprises were playing a growing role in the global economy emerged in the past years. These Enterprises undertook a significant share of (the national) outward of foreign direct investment, and for this reason, policymaking may be required. Therefore, in this Communication, the Commission proposes a Regulation establishing a framework to screen foreign direct investments in the EU. This is a proportionate and transparent measure to ensure the rules-based, predictable, non-discriminatory investment regime and set up parallel rules with the principles of the relevant case law of the Court of Justice of the European Union.[46]

[42] Reflection Paper on the Harnessing globalisation, pp. 15. (https://commission.europa.eu/system/files/2020-07/reflection-paper-globalisation_en.pdf).
[43] Communication from the Commission on Welcoming Foreign Direct Investment while Protecting Essential Interests, pp. 2: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2017:0494:FIN:EN:PDF
[44] See as an example the above-mentioned Made in China 2025.
[45] World Investment Report, 2017 – Investment and the digital economy realized by the UNCTAD. pp. 88-89.: https://unctad.org/system/files/official-document/wir2017_en.pdf
[46] In particular in line with the following case law of the ECJ: Case C-483/99, Commission v France, Case C-463/00, Commission v Spain, Case C-326/07, Commission v Italy, Case C-212/09 Commission v Portugal, and Case C-244/11 Commission v Greece.

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5. Toward the Regulation

In September 2017 the European Parliament and Council have proposed the Regulation,[47] to ensure that foreign investment remains a major source of growth in the EU while protects the EU's core values. In November 2017, the European Economic and Social Committee (hereinafter: EESC) issued its Opinion.[48] They stated that the proposal was welcomed, however, whilst the Committee expressed different points of view toward a more powerful regulation. Firstly, the "security" and "public order" definitions are limited to reach a minimum level of agreement between the Member States (and to ensure their regulatory flexibility) for example, to the field of critical infrastructure, electronic communications, cybersecurity, and cybersecurity products and services. According to EESC, the further development shall consider additional factors that can affect security and public order. They shall be fair trade distorting practices; constraints on competition; lack of transparency of investments. Secondly, it advocates FDI screening process on the ground of reciprocity, and "the EESC calls on the Commission to apply the principle of reciprocity in all negotiations with the third countries on FDI, hence often the European investors faced barriers to investing outside the EU. Thirdly, the Regulation should include a separate screening procedure for foreign direct investment made (directly, or indirectly, through an economic entity) by third-country governments.[49] Lastly, The EESC is concerned that the European Commission only reserves investment screening[50] for cases when an investment might affect projects or programs of Union interest[51]. (As an

[47] Proposal for a Regulation of the European Parliament and of the Council on establishing a framework for screening of foreign direct investments into the European Union, 2017/0224 (COD): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2017:487:FIN

[48] The opinion of European Economic and Social Committee on establishing a framework for screening of foreign direct investments into the European Union (2018/C 262/16): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=eesc%3AEESC-2017-05490

[49] Point 2.33 of the Opinion: The EESC shares the Commission's view that screening procedures should consider whether a foreign investor is controlled by the government of a third country. However, it is not a limitation (that FDI screening is only applicable if the transaction is connecting to a 3. Country), but a different indicator, and therefore a different screening regime would be welcomed (not the private investment's). And according to EESC: "The EU has enacted the Agreement on Subsidies and Countervailing Measures (ASCM). It is, therefore, possible to reject foreign direct investment if essential security interests are at stake, which happens, in the EESC's view, when societal values have to be upheld. *Foreign direct investment can be restricted more comprehensively* if an investor is controlled by, or has close ties to, a government."

[50] Point 1.9. of the Opinion declared that: "(…) the European Commission only reserves the right to screen investment *when such investment might affect projects or programs of Union interest.* Where foreign direct investment has a cross-border impact on the whole EU or parts of it, the EU needs to make use of its competence in terms of investment screening." It seems that EESC considered to establish an FDI screening regime, which is more similar to the Community dimension concentrations screening and decision-making (exclusive) power of the Commission according to the European Merger Regulation (hereinafter: EUMR).

[51]According to the accepted and in effect FDI screening Regulation, in its Article 8: „*Projects or programs of the Union interest* shall include those projects and programs which involve a substantial amount or a significant share of Union funding, or which are covered by Union law regarding critical infrastructure, critical

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opposite, the Commission declared several times that the responsibility of investment screening "rests with Member States".[52])

The European Parliament has proposed some amendments[53] in June 2018. Firstly, according to t the Parliament, strict definitions are not forwarding. "(…) It would be *unwise* to make these *concepts precise definitions*, because this would mean that the mechanism would no longer be viable on a case-by-case basis and be subject to too many constraints." As such, the Parliament proposed *investors as "– a natural or legal person – are said to be foreign when they are also directly or indirectly under the ultimate control of non-European entities or States"* (using the category of *ultimate investor*.) And the link between foreign investment and security / public order "should not be limited to taking into account only the control[54] exercised by the government of a third country but should include the context and the condition under the investment is being realised, considering also the openness of the sector in the country of origin.

A contrario, in the adopted text the definition of foreign direct investment is "an investment of any kind by a foreign investor aiming to establish or to maintain *lasting and direct link* between the foreign investor and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity in a Member State, including investments which enable effective participation in the *management or control* of a company carrying out an economic activity." The foreign investor is "a natural person of a third country or an undertaking of a third country, intending to make or having made a foreign direct investment". And other precise

technologies or critical inputs which are essential for security or public order. The list of projects or programs of Union interest is set out in the Annex."

[52] As such, see in: Communication from the Commission: Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452), 2020/C 99 1/01. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020XC0326(03)

[53] The European Parliament has proposed some amendments to the act: https://www.europarl.europa.eu/RegData/seance_pleniere/textes_deposes/rapports/2018/0198/P8_A(2018)0198_EN.pdf

[54] According to the Parliament: "There are various different ways of taking over control of an undertaking (acquisition, a shareholders' agreement, governance rights, choice of directors, targeting of the shareholders' meeting, 'activist' funds), whatever the assets in the hands of the investor, even in the case of portfolio investments."

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definitions are appeared, such as, FDI screening[55], screening mechanism[56], foreign direct investment undergoing screening[57], screening decision[58], undertaking of a third country[59].

6. The FDI-screening Regulation, as a European frame

After considering the above-mentioned resolutions and amendments, by ordinary legislative procedure, the FDI screening regulation was accepted, and entered into force in 2019, and was fully applicable from 2020. This European frame functions as *coordinating legal instrument*, as Article 4 provides a non-exhaustive list of factors[60] what can be taken into consideration when the Member States plan to screen an FDI on the grounds of security or public order. This aspect of the Regulation moves toward a "directive" as there is not any obligation on Member States either to realise the actual investment screening process, or to establish a national FDI screening regime[61]. "The framework for the screening of foreign direct investments and for cooperation[62] should

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[55] Article 2 (3) of the FDI screening Regulation: "A procedure allowing to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments."

[56] Article 2 (4) of the FDI screening Regulation: "An instrument of general application, such as a law or regulation, and accompanying administrative requirements, implementing rules or guidelines, setting out the terms, conditions and procedures to assess, investigate, authorize, condition, prohibit or unwind foreign direct investments on grounds of security or public order."

[57]Article 2 (5) of the FDI screening Regulation: „A foreign direct investment undergoing a formal assessment or investigation pursuant to a screening mechanism."

[58] Article 2 (6) of the FDI screening Regulation: "A measure adopted in application of a screening mechanism."

[59] Article 2 (7) of the FDI screening Regulation: "An undertaking constituted or otherwise organized under the laws of a third country."

[60] In determining whether a foreign direct investment is likely to affect security or public order, Member States and the Commission may consider its potential effects on, inter alia: a.: critical infrastructure, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure; b.: critical technologies and dual use items as defined in point 1 of Article 2 of Council Regulation (EC) No 428/2009, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies; c.: supply of critical inputs, including energy or raw materials, as well as food security; d.: access to sensitive information, including personal data, or the ability to control such information; e.: the freedom and pluralism of the media. The above-mentioned list is non-exhaustive, nor an order of importance, furthermore the points can be considered alternatively.

[61] This provision was opposed by EESC, since in their opinion was that the proposal is only „a first step in the right direction," furthermore, the European Commission promotes to have FDI-screening nationally, however, the Regulation does not impose any obligation to legislate.

[62]*Cooperation mechanism* works amongst the Member States and the Commission for being able to exchange information and raise concerns related to specific investments. In the member State, where the investments taken place: must provide information on the investment upon request, and must notify cases which undergo national screening, and can request opinions. Other Member States: can add comments / can request further information, the European Commission has the same rights. The Member State where the investments take place: must consider the received comments or opinions, and has the right to authorize, possibly with conditions, or prohibit the investment as a final step – pursue the Article 6-10 of the Regulation.

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provide Member States and the Commission[63] with the means to address risks to security or public order in a comprehensive manner, and to adapt to changing circumstances, while maintaining the necessary flexibility[64] for Member States to screen foreign direct investments on grounds of security and public order taking into account their individual situations and national specificities."

The ambitious aim of the Regulation was to move toward the greater legal certainty, by the meaning of developing the European frame to help member states to introduce their national FDI screening regime. Moreover, to safeguard legal certainty for those Member States that have established national investment screening mechanisms as being harmonized, hence to 2017, most of the European countries had rather different FDI screening process.[65] With other words, according to the opinion of Tamara Capeta, the Regulation "… may be understood as restoring the lawfulness of Member States' existing foreign direct investment screening mechanisms".[66] As such, the Regulation 'delegates' competences back to the Member States where they lost it with the Treaty of Lisbon, since, the Union has exclusive competence[67] in *common commercial policy.* The Treaty of Lisbon enlarged the scope[68] of this policy and implemented foreign direct investments. It

[63] In regard FDI screening mechanism, *Commission* has not only right for the above-mentioned cooperation, but the Member States shall *submit to the Commission an annual report* of the aggregated information on foreign direct investments that took place in their territory. Furthermore, according to the *Article 8*, where the Commission considers that a foreign direct investment would affect projects or programs of *Union interest* on grounds of security or public order, the *Commission can issue an opinion addressed* to the Member State where the foreign direct investment is planned or has been completed. The procedures of the Articles 6 and 7 should be applied with modifications of Art. 8. And The Commission itself has the right to adopt delegated acts (according to Article 16) to amend the *list of projects and programs of Union interest.* Moreover, the Commission must *evaluate the functioning and effectiveness of this Regulation* and present a report to the European Parliament and to the Council according to the Article 15. Even if the Commission does not possess exclusive right to pursue the screening process, nonetheless, it is one of the key elements of FDI screening.

[64] "Necessary flexibility" is required especially because there is no Europe-wide investment screening mechanism, but many national ones. Nevertheless, we must bear in mind to enforce the values of the European Union as a whole is one of the key responsibilities of the European Institutions. As such, the European Commission has the right to guide Member states to accomplish this aim. Such guidance emerged because of the challenges of the Covid-19 pandemic in 2020 (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020XC0326(03)) and, because of the challenges of the Russian-Ukrainian armed conflict in 2022: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022XC0406%2808%29

[65] According to the Communication from the Commission on Welcoming Foreign Direct Investment while Protecting Essential Interests, 2017, point 5.1.: "Nearly half of EU Member States have in place mechanisms for screening foreign direct investments. This is the case for Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Italy, Poland, Portugal, Spain, and the United Kingdom." https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2017:0494:FIN:EN:PDF

[66] Point 35 of Opinion of the Advocate General in the Xella case.

[67] Article 2 of the Treaty on Functioning of European Union (hereinafter: TFEU) rules the competence-sharing. Exclusive competence (Article 2 (1)) is when the Member State cannot legislate without any authorization, even if the Union does not do any legislative steps. A contrario, in case of shared competence (Article 2 (2)), the Member States can act, if there is not any pre-empted measure is adopted at EU level.

[68] Article 3 (1) e), and Article 207 (1) of the TFEU

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is understood as the already existing FDI-screening mechanism ruled were adopted in the lack of legal basis. The ECJ ensured the above-mentioned reasoning in its opinion to Singapore Agreement:[69] "Article 207 (1) TFEU provides that EU acts concerning 'foreign direct investment' fall within the common commercial policy. It follows that the European Union has exclusive competence, to approve any commitment vis-à-vis a third State relating to investments made by natural or legal persons of that third State in the European Union and vice versa which enable effective participation in the management or control of a company carrying out an economic activity."

In this Singapore Agreement Opinion, the Court has declared another key character in relation to foreign direct investments. ECJ adopted the same definition[70] as the one used to describe the internal market concept of 'direct investment' and the Court refers to its internal market case law.[71] Which led us to certain overlap and tension between the shared competencies used in internal market legislation area and exclusive competence of the EU institutions in common commercial policy area. According to the jurisprudence of ECJ: "Direct investment consists in investments of any kind made by natural or legal persons which serve to establish or maintain *lasting* and *direct links* between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity."

7. Defining the foreign direct investments: lasting link between investor and the undertaking

Investments from third countries, can be understood under the *free movement of capital according to the Article 63 of the TFEU*. This freedom is one of the four freedoms framed by Internal Market,[72] and it is a unique one, since the only freedom providing rights to not only European citizens and enterprises, but third country's as well. This Article prohibits any restriction to capital movements between Member States and applicable to capital movements from third countries. However, investment screening mechanisms are a way of restriction on the free movement of capital,[73] because the investor must undergo necessary administrative steps, for example notification duty. Furthermore, FDI screening can end up with the prohibition of the transaction. Such a limitation can be only justified when necessary and proportionate for the achievement of the objectives defined in the

[69] The Opinion of the ECJ on the Singapore Agreement, May 2017 (EU:C:2017:376): https://curia.europa.eu/juris/document/document.jsf?docid=190727&doclang=en
[70] Point 87. of the Singapore Agreement
[71] See, inter alia, judgments of 12 December 2006, Test Claimants in the FII Group Litigation, C-446/04, EU:C:2006:774, paragraphs 181 and 182; of 26 March 2009, Commission v Italy, C-326/07, EU:C:2009:193, paragraph 35; and of 24 November 2016, *SECIL*, C-464/14, EU:C:2016:896, paragraphs 75 and 76.
[72] Direct investment also forms part of the free movement of capital and thus falls within the scope of the internal market, according to the case law of ECJ, see for example in judgment of 22 October 2013, Essent and Others (C-105/12 to C-107/12, EU:C:2013:677, paragraph 40).
[73] Point 58-59 of Judgement in Xella case.

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Treaty, including on public security and public policy grounds[74] or for overriding reasons in the general interest, as defined by the Court of Justice of the European Union[75]. The ECJ clarifies that Member States enjoy discretion in determining public policy and public security requirements in the light of their national needs, however, these public interests cannot be determined unilaterally by the Member States and must be interpreted strictly. It must rely on a genuine and sufficiently serious threat to a fundamental interest of society. In case of such restriction on fundamental rights cannot be abused to purely serve economic purposes.

However, as it visible from the previous case law of the ECJ, if the investment crosses only EU internal borders, it may fall within the scope of either the free movement of capital, or the *freedom of establishment (Articles 49 and 54 TFEU)*, depending on the form of participation at issue.[76] Therefore, the depending criteria is if direct investment, is for shareholding to enable an investor to participate effectively in that undertaking's management and control (and therefore forming a *lasting* link), then the direct investment is governed by the rules on freedom of establishment.[77] On the other hand, if the aim of the investor is only to acquire a short-term or solely making financial (such as by the assist of the capital markets) investments without any intention to influence the management and control of the undertaking then the investment will be governed by the free movement of capital[78].

8. Defining the foreign direct investments: direct link between investor and the undertaking

In the definition of foreign direct investment, the direct link between the investor and its investment is demanded, therefore, the Regulation itself tighten its scope when preclude indirectly owned or influenced (holding) companies. *Indirect link*[79] only examinable in the meaning of the *link between the foreign investor and its funding option*, whether it is directly, or indirectly controlled by any third Country's Government.[80] Literally, it is "possible for

[74] This reasoning is deduced from Article 65 of the TFEU.
[75] See for example the previous case law of ECJ, as Case C-265/95, Commission v France ("strawberries"), paragraph 33. Case C-463/00, Commission v Spain, paragraph 34; Case C-212/09 Commission v Portugal, paragraph 83 and Case C-244/11 Commission v Greece, paragraph 67.
[76] See in the judgement of Test Claimants in the FII Group Litigation *(*C-446/04, EU:C:2006:774, paragraph 37), Test Claimants in the FII Group Litigation (C-35/11, EU:C:2012:707, paragraph 95).
[77] See, in judgment of 13 April 2000, Baars (C-251/98, EU:C:2000:205, paragraphs 21 and 22).
[78] See, inter alia, in judgement of 10 February 2011, Haribo Lakritzen Hans Riegel (C-436/08) and Österreichische Salinen *(*C-437/08), EU:C:2011:61, paragraph 35.
[79] I would like to refer to the Parliament's justification, where stated that exact definitions cannot perfectly express the scope of such delicate wording.
[80] The ration behind might be parallel with the ratio of the recently accepted Foreign Subsidies Regulation (hereinafter: FSR). As such: „Inward investments to the EU are constantly growing. They increasingly focus on particular sectors, on larger than average enterprises, and increasingly emanate from state owned

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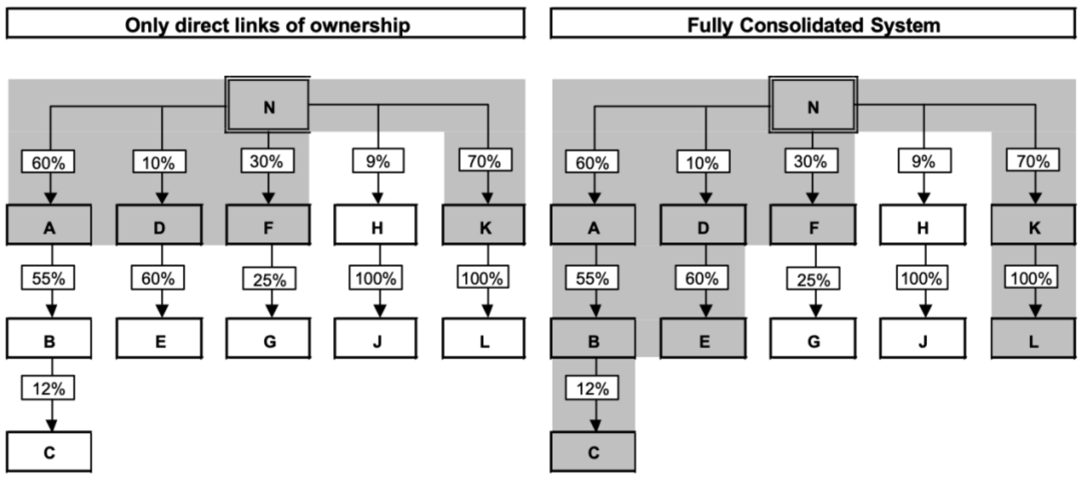
Member States and the Commission *to take into account the context and circumstances of the foreign direct investment, in particular* whether a foreign investor is controlled directly or indirectly, for example through significant funding, including subsidies, by the government of a third country or is pursuing State-led outward projects or programs."

Therefore, the indirect relation is just a guidance detect whether the funding of the investment was realized by any Government of third Country. However, in the Preamble of the Regulation it is stated that FDI-screening mechanism "should cover investments from within the Union by means of *artificial arrangements that do not reflect economic reality and circumvent* the screening mechanisms and screening decisions, where the investor is ultimately owned or controlled by a natural person or an undertaking of a third country." This is a rather interesting tendency; hence this provision literally excludes any holding structure under the scope of the Regulation.

Over the past decades, several different holding structures (indirect foreign direct investment models) has developed and on the other side of the scale is the fully consolidated system of FDI interpretation exist. The following figure (realized by IMF Committee in 2004[81]) is visible for illustration purpose:



enterprises or investors with strong links to governments. In contrast to this, since 2016, at global level, restrictions to foreign direct investment are increasing. Recently, a series of take-overs of European companies involved foreign *investors with strong ties to their home governments which strategy focus* on the purchase of European companies that develop technologies or maintain infrastructures that are essential to perform critical functions in society and the economy."

[81] The Seventeenth Meeting of the IMF Committee on Balance of Payments Statistics, Pretoria, October, 2004: On the indirect FDI Relationships and Alternatives to the Fully Consolidated System. See here: https://www.imf.org/external/pubs/ft/bop/2004/04-32.pdf

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Under the "Fully Consolidated System", Company A is a subsidiary of N. Company B is a subsidiary of A and so the subsidiary of N, also (even though only 33 per cent of B is indirectly linked to Company N). Company C is an associate of B and, through the chain of subsidiaries A and B, of N as well, even though only 4 per cent of C is indirectly linked to Company N. Company D is an associate of N, Company E is a subsidiary of D and thus an associate of N even though only 6 per cent of E is indirectly attributable to N. Company F is an associate of N and G is an associate of F, but G is not an associate of N. Company H is also not a subsidiary of N nor Company J, hence the ownership shares of Company N within Company H does not pass 10%. Company K is a subsidiary of N and L is a branch of K and thus of N. Thus, foreign direct investment screening based on the Fully Consolidated System would cover A, B, C, D, E, F, K and L, however, Company G, H and J would not be covered.

While the strictly limited direct link (ownership, or influence) model exclude every indirect link amongst its examination area, the fully consolidated system let every type of indirect linkage. With other words, an associate of the associate would break the direct investment chain, while all types of subsidiaries, branches and associated companies are within the indirect FDI examination. According to the IMF Committee, the model limited to direct link of ownership "should be rejected on the grounds that it would significantly diminish the analytical value of FDI figures"[82].

9. FDI screening jurisprudence of the ECJ, the Xella case

Xella case is until now the first FDI-related case in the jurisprudence of European Court of Justice, however considerably it might not be the last one since there is a mighty discrepancy between the interpretation of the Advocate General and the final judgement of the ECJ. Namely, the scope of the Regulation was understood differently as such being limited only to direct foreign direct investments or widen its scope toward indirect foreign direct investments also.

The final conclusion of the Advocate General[83] was: "Article 4(2) TEU, Article 65(1)(b) TFEU and Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union *do not preclude* national legislation which allows for the screening of foreign direct investment of third-country provenance into an EU undertaking, *carried out through another EU undertaking, if that investment results in effective participation of the third Country* undertaking in the management or control of the EU undertaking in which it has invested." And on the other hand, the final conclusion of the Court[84] was: "*The provisions of the TFEU on freedom of establishment must be interpreted as precluding a* foreign investment filtering

[82] The Seventeenth Meeting of the IMF Committee, 2004, pp. 2.
[83] Point 95 of Opinion of the Advocate General of the Xella case.
[84] Point 76 of the Judgement of Xella case.

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mechanism provided for by the legislation of a Member State by means of which a resident company which is a member of a group of companies established in several Member States, over which an undertaking of a third country has decisive influence, *may be prohibited from acquiring ownership of another resident company regarded as strategic*, on the ground that the acquisition harms or risks harming the national interest in ensuring the security of supply to the construction sector, in particular at the local level, with respect to basic raw materials (…).”

The details of the dispute are the following. Xella Magyarország Építőanyagipari Kft. (‘Xella Hungary’) is a Hungarian company that produces concrete products for construction purposes. It is 100% owned by a German company. That German company is owned by a Luxembourg company, which is owned by a Bermudan company. This company is a subsidiary of Lone Star Funds, a United States private equity firm, where the founder and the ultimate owner is a natural person with Irish nationality. And this first company, Xella Hungary wanted to takeover of 100% of the holdings in „Janes és Társa” Szállítmányozó, Kereskedelmi és Vendéglátó Kft. (‘Janes’), a Hungarian undertaking. Janes owns a quarry in Hungary. It is engaged in the extraction of certain construction aggregates, namely sand, gravel and clay. Its production of those aggregates represents 0.52% of Hungary’s national production. According to the referring court, the applicant is the largest purchaser of Janes (acquiring approximately 90% of its total production). The remaining 10% of material extracted by Janes is acquired by local enterprises.

By decision of 20 July 2021, the relevant Hungarian Minister blocked that acquisition, by a decision adopted pursuant to Paragraph 283 of Law LVIII 2020, which empowers the Minister to examine whether the notified transaction damages or threatens to damage Hungarian national interest, public security, or public policy. This examination ended up with a veto (the transaction was blocked by the Minister). In the statement of reasons, the Minister notes that the applicant’s ownership structure consists indirect ownership by Luxembourg and Bermudan companies. Secondly, that one of the problems affecting the construction sector in Hungary is the scarcity of sufficient quantities of building materials. Therefore, it is strategically important that the extraction and supply of raw materials be in secure and foreseeable in the region. If Janes would be in Bermudan hands, this would represent a long-term risk in terms of ensuring the supply of these materials.

Before the final judgement, the European Commission[85] shared its point of view. According to the Commission, the FDI Screening Regulation cannot be applied to this case since *European undertakings cannot be the subject of screening under this*, as according to the definition of the Regulation, a ’foreign investor’ is a natural person or an undertaking of a third country. With other words, so exclude the pre-question of whether this European undertaking is indirectly linked to non-European undertakings, within a complex ownership structure from the examination area. Because solely focusing to the

[85] Point 29 of the Judgement of Xella case.

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wording of the Regulation, its *ratione personae* is not applicable to an EU-based company. After this reasoning, the Regulation is generally not applicable to such cases, and the Court should focus and judicate only on whether the internal market freedom was legitimately restricted or not. This reasoning was supported by case law[86] as the relevant *company's 'nationality' depends solely on where its corporate (formal) seat is,* and the (factual) shareholding and ownership structure is irrelevant. This might be the reason why the final judgement in 2023 followed this logic of reasoning.

From the point 32, 33 and 34 of the Judgement of Xella case the restrictive interpretation of FDI-definition is deductible. Started as ensuring the scope of FDI Regulation is limited to investments in the European Union made (directly) by undertakings constituted or organised under the laws of a third country. By contrast, the foreign investment filtering mechanism provided for also situations, where investments are made by undertakings registered in Hungary or in another Member State *over which an undertaking registered in a third country has 'majority control' within the meaning of Section 8:2 of the Civil Code*. "Consequently, since that second situation is not covered by Article 1 of Regulation 2019/452, that national legislation, to that extent, falls outside the scope of that regulation, with the result that the acquisition at issue in the main proceedings, which concerns the second situation, also does not fall within the scope of that regulation."

A contrario, the Advocate General explained that the Regulation used the *'any kind of investment'* wording, and this means that the investment itself is to acquire control though a company (or more). (...) "it imposes no limitation as to the structure or the investment process itself. Accordingly, *for an investment* to fall within the scope of the FDI Screening Regulation, the investment process *need not necessarily be conducted directly* (such as where a foreign investor acquires control over an EU undertaking by directly buying its shares) but may be carried out indirectly (such as where a foreign investor acquires control over an EU undertaking by acquiring its shares through another EU undertaking). What matters is *who* ultimately *acquires control* over the EU undertaking in question."[87] This reasoning goes parallel with the justification wrote within the Parliament's amendment proposal in 2018.[88]

Not surprisingly, Italy[89] supported this interpretation. An argument in favor of this reasoning is that if the Regulation exclude indirect foreign direct investments, then it

[86] See, inter alia, in judgment of 1 April 2014, Felixstowe Dock and Railway Company and Others (C-80/12, EU:C:2014:200, paragraph 40)
[87] Point 43 of Opinion of Advocate general of the Xella case.
[88] The European Parliament has proposed some amendments to the Regulation on plenary sitting: https://www.europarl.europa.eu/RegData/seance_pleniere/textes_deposes/rapports/2018/0198/P8_A(2018)0198_EN.pdf pp. 9, pp.21
[89] Italy has a specialized FDI screening regime, so-called "Golden Power regime". More about the FDI restriction regulatory framework of Italy can be visible here, as a compilation made by practicing lawyers from Italy:

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undermines the very objective of the screening. FDI screening mechanisms exist to decide whether an FDI damages or threatens to damage a national public order or security or Union interest. It seems that only direct relation of a third country's private sector investor toward a domestic undertaking is considered. What is interesting, hence a direct link does not assume a complex ownership-structure what can damage or threaten to damage the public order or security.

However, the exceptional, circumvention provision of supposed indirect funding of any third Country's Government requires a capital screening to decide whether it will be harmful or not. With the words of Tamara Capeta: "A transaction must first fall within the scope of the FDI Screening Regulation in order for it to be determined whether it is indeed intended to circumvent the national screening mechanisms or decisions."[90] And if we do not accept this extended interpretation of the aim of FDI screening Regulation, we ignore the real purpose of screening for foreign direct investment[91].

10. Complementary set with related Union legal instruments (EUMR, FSR)

10.1. Merger control

FDI-screening not necessarily overlap with merger control; hence their scope is different. FDI screening focus on whether the planned transaction will result the infringement of public interest and security, while merger control focus on whether the planned concentration will result the infringement of the competition on the relevant market. According to the OECD[92]: "FDI screening reviews and merger control reviews are generally separate and independent and may not be necessarily triggered by the same corporate transactions[93]. Yet, the introduction, expansion, or strengthening of FDI screening mechanisms raises the question of whether and how they interact and shall co-ordinate

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https://www.cliffordchance.com/insights/resources/blogs/antitrust-fdi-insights/2022/09/recent-amendments-to-the-italian-golden-power-regime-the-pre-notification-procedure.html

[90] Point 47 of Opinion of Advocate general of the Xella case.

[91] Point 45 of Opinion of Advocate general of the Xella case.

[92] The Relation between FDI screening and merger control reviews – OECD Competition Policy Roundtable Background Note, 2022: https://web-archive.oecd.org/2022-11-03/644554-the-relationship-between-fdi-screening-and-merger-control-reviews-2022.pdf

[93] According to the above-mentioned OECD roundtable document: „Although FDI screening mechanisms pursue *different objectives* than merger control reviews and are *mostly autonomous* from the latter, *concerns may arise from the interactions between decisions* taken under the two separate review mechanisms when they both apply to a given transaction, especially regarding the design of remedies, and *may bring a risk of undermining each other*." Triggers can happen, when the different regimes (FDI screening and merger control) examine the same transactions, as such was in the case of *Aegon / VIG transaction*, where the relevant Hungarian Minister after (the already existing, and activated) FDI screening mechanism of Hungary, vetoed the transaction of Aegon Magyarország Zrt. by Vienna Insurance Group, on the ground that the planned acquisition threatens Hungary's legitimate interests. And European Commission has concluded that this decision has breached Article 21 of EUMR, which states that EC has exclusive competence for concentrations having Union dimension. https://ec.europa.eu/commission/presscorner/detail/es/ip_22_1258

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with merger reviews potentially involving the same transactions." Competition and investment policies have a complex and ambiguous relationship: competition law can affect inward FDI[94] and investment policies can affect competition in multiple ways.[95]

The European Merger Control Regulation[96] is the core legal basis. Its Preamble ensures the principle of open market economy with free competition, what is essential for the further development of internal market. That can form major corporal reorganization, for example, concentrations, what are welcomed in the sense of increasing competitiveness. However, it should be ensured that the process of this reorganization does not result in lasting damage to competition. For accomplishing this goal, the Community law must include provisions governing concentrations may significantly impede effective competition in the common market or in a substantial part of it.[97] The application of EUMR is defined according to the *geographical area* of activity of the undertakings concerned and limited by *quantitative thresholds* to cover those *concentrations*[98] which have a *community dimension*[99]. The relevant authority, who control (screen) these type of concentrations, is the European Commission, and exclude Member State's national legislation in case of Community dimension concentrations. This provision is ensured in the EUMR, parallel with the Preamble of the FDI screening Regulation[100].

However, Article 21 (4) of EUMR empowers Member States to take "appropriate measures" to protect legitimate interests. This regulation contains a taxative list of this legitimate interest. These are: public security, plurality of the media and prudential rules. This list can be expanded by any Member State, only if they are compatible with the general principles and other provisions of Community law, and communicated to the Commission, for later recognition. The appropriate measure can be the FDI screening mechanism, as " the respective scope of application of the two regulations overlap, the *grounds for screening* set out in Article 1 of the proposed Regulation and the notion of *legitimate interests* within the meaning of Article 21(4), third paragraph, of the EU Merger Regulation should be interpreted in a coherent manner, without prejudice to the

[94] For example, by declaring open competitive markets, neutrality principles and limiting state subsidies.
[95] For example, by providing a better investment environment, or by influencing market entry, market concentration, and supporting innovation.
[96] The Council Regulation No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), hereinafter: EUMR
[97] The preamble of EUMR
[98] Concentration definition is in Article 3 of the EUMR.
[99] Community dimension threshold is specified in Article 1 of the EUMR.
[100] According to the point 1 of Article 21 of EUMR: „This Regulation *alone shall apply* to concentrations as defined in Article 3." And the preamble (36) of FDI screening Regulation: "When a foreign direct investment constitutes a concentration falling within the scope of Regulation 139/2004, *the application of this Regulation should be without prejudice to the application of Article 21(4) of Regulation 139/2004*. This Regulation and Article 21(4) of Regulation 139/2004 should be applied in a consistent manner."

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assessment of the compatibility of the national measures aimed at protecting these interests with the general principles and other provisions of Union law."[101]

10.2. Foreign Subsidies

Foreign Subsidies are regulated with a rather new legislative act.[102] The Regulation on foreign subsidies distorting the internal market is applicable from the July of 2023. EUMR and FSR has the same goal: preserve and ensure the competition inside the internal market, as an open internal market enables both European and foreign undertakings to compete. In the Union a sophisticated and effective system of State aid control works, which prevents Member States from granting State aid unduly competition distortion in the internal market. However, before FSR, there was not any Union instruments if this distortion is caused by foreign subsidy[103].

FSR laid down rules and procedures to investigate foreign *subsidies[104] that actually or potentially distort the internal market[105].* Internal market distortion can be made, if an undertaking what benefits the foreign subsidy, engages in economic activity inside the Union. The Commission is the only competent authority to apply this Regulation (in any sector): to have the power to review foreign subsidies based on a prior notification by the undertaking to the Commission, in particular in *concentrations*[106] and *public procurement procedures.*[107] The Commission also has the right to start ex officio review in any *other market situation*[108], and after deciding whether a foreign subsidy will distort internal market. If yes, prohibition, acceptance with commitments, or permitting the transaction, and fine imposing is the consequence to take.

To conclude, we can say FDI screening Regulation fits into the environment of these legal acts, as reinforcing and complementing each other. Not every FDI transaction is made as a concentration, and not every FDI is financed by a third Country. However, in the special case of overlapping, all type of 'control mechanism' can be applicable, and it can cause concurrence amongst proceedings and relevant authorities, also[109]. In the theoretical

[101] The preamble (36) of FDI screening Regulation.
[102] Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (hereinafter: FSR)
[103] Preamble of the FSR
[104] The existence of foreign subsidy is defined in Article 3 of FSR.
[105] Actual distortion is enumerated in In Article 4 of FSR, and potential distortion is enumerated in Article 5 of the FSR.
[106] Chapter Three of the FSR
[107] Chapter Four of the FSR
[108] Chapter Two of the FSR
[109] „This would result in Member States notifying DG Trade of their screening mechanisms under the EU FDI Regulation, and in parallel applying to DG COMP for recognition of the relevant screening grounds as EUMR legitimate interests." according to Alec Burnside and Adam Kidane: Merger Control meets FDI: the multi-stop shop expands. DOI: https://doi.org/10.4337/clpd.2022.02.01

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example of concentration, realized by a non-European M&A transaction of a European undertaking: FDI screening is applicable, and the respective Member State has the power to screen the FDI whether it damages public interest / security purpose. If this concentration has Union dimension, the European Commission has the power to progress the merger control, according to Article 21. If, the concentration does not have Union dimension, the competition authority of the respective Member State is the relevant authority for merger control. In the theoretical scenario of the above-mentioned concentration is financed (even indirectly) by any foreign Government, the undertaking must notify the Commission for FSR investigation purpose, also. FDI screening mechanism is not emptied, but serviceable in the sake of public interest / security reasons the Member States. If FDI screening mechanism is not applicable in a Member State, public interest and security reason cannot be taken into consideration. Not even by merger control nor by foreign subsidies investigation (neither from the side of Commission since the decision is on the Member State to establish FDI screening mechanism).

11. Assessment of the FDI screening mechanisms and tendencies

The FDI screening regulation stipulates an obligation for the European Commission to review the current situation of in-and outward FDI Europe-widely. The first annual report[110] was published at the end of 2021. It shows that the into the EU27 the inward FDI fell sharply in 2020. That shows a parallel tendency with the global *FDI flows* according to the United Nations Conference on Trade And Development (hereinafter: UNCTAD) World Investment Report 2021.[111] In this world report it is visible, that in 2020, FDI flow fell by one third to $1 trillion, well below the lowest point reached after the global financial crisis a decade ago and both, developed and developing countries were hit hard[112]. According to the UNCTAD report, the pandemic has lasting effect on investment *policymaking*: trend towards more restrictive admission policies, more competition in attracting investment in the affected industries, and greater reference to online and digital tools. This policy-making trend was visible in the Europe: during the reporting period 24 out of 27 EU Member States either adopted a new national FDI screening mechanism; or amended the already existing mechanism; or initiated a consultative or legislative process toward the adoption of a new mechanism[113]. The realized formal FDI screening proceedings in numbers: 80% of the transactions were not formally screened,[114] and approximately 20% of the transactions

[110] European Commission, Directorate-General for Trade, First annual report on the screening of foreign direct investments into the Union, Publications Office of the European Union, 2021, https://data.europa.eu/doi/10.2781/000880

[111] United Nations Conference on Trade And Development: World Investment Report, 2021 – investing in sustainable recovery: https://unctad.org/system/files/official-document/wir2021_en.pdf

[112] There were divergencies in statistics according to about what sector we are talking about: some sectors such as tourism, leisure, aviation, and marine transportation were merely affected, while others: medical supplies, pharma manufacturing, and e-commerce did unprecedented deal-making.

[113] First annual report on the screening of foreign direct investments into the Union, pp.9.

[114] Either because of an evident lack of impact on security or public order, or because they fell outside the scope of the national screening mechanism (i.e. ineligible).

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underwent formal screening proceedings. Out of this, 91% of the dossiers formally screened were approved[115]. A very small portion (2%) were prohibited, and 7% were aborted. The main targeted sectors were Manufacturing, ICT, and financial service activities.[116] Of the 265 cases notified, 29% constituted multi-jurisdiction FDI transactions, and opinions were issued in less than 3% of the cases[117]. More than 90% of these cases were notified by five Member States, namely Austria, France, Germany, Italy and Spain. As for the origin of the investor, the five main countries of origin were the US, the UK, China, Canada and the United Arab Emirates.

The second annual report,[118] was published at the end of 2022, and shows that *global inflows* in 2021 have increased with 52% in comparison to 2020 and increased with 11% with respect to the pre-COVID-19 levels of 2019. Greenfield investment's top 5 sectors were in increasing order: Hospitality, Transport, Manufacturing, ICT and Retail, while M&A transactions were made differently: from top order: ICT, Manufacturing, PST, Retail, Finance. The same is visible in the UNCTAD World Investment Report in 2022,[119] as international investment flows are vital for sustainable development in the poorer regions of the world. Increasing investment to support a sustainable and inclusive recovery from the pandemic is now a global *policy priority*. This entails promoting investment in infrastructure and the energy transition, in resilience and in health care. The European Commission continuously encouraged Member States, both at political[120] and technical aspect, to realize screening mechanisms at national level. By the end of this period, only 2 Member States where no publicly reported initiatives were started, Bulgaria and Cyprus. About the formally initiated screening processes in numbers: out of the 1 563 cases, approximately 29% were formally screened, where 73% of them were authorized without conditions. 23% of the decisions involved an approval with conditions or mitigating measures, and only 1% was blocked. In 2021, 13 Member States submitted a total of 414 notifications (Article 6), and five Member States, namely Austria, France, Germany, Italy and Spain, were responsible for more than 85% of these notifications. The origin Countries of the ultimate investor were the USA, the UK, China, the Cayman Islands and Canada. Russia was lower than 1.5% of the cases.

[115] The large majority (79%) without conditions, 12% with conditions.
[116] Manufacturing and ICT accounted for 67% of all transactions.
[117] From 11 October 2020 through 30 June 2021 a total of 265 notifications were submitted by 11 Member States pursuant to Article 6 of the FDI Screening Regulation.
[118] European Commission, Directorate-General for Trade, Second annual report on the screening of foreign direct investments into the Union, Publications Office of the European Union, 2022: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022DC0433
[119] United Nations Conference on Trade And Development: World Investment Report, 2022 – international tax reforms and sustainable investment: https://unctad.org/system/files/official-document/wir2022_en.pdf
[120] The already cited 2 Commission Communication had emerged in this period: the one for supporting Member States on the ground of healthcare, and in the context of the Russian – Ukranian armed conflict.

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According to the third annual report,[121] in 2022, the global FDI were 34% above the 2020 levels, yet, it displayed a decrease of 14.3% compared to 2021. This trend is shown in the UNCTAD World Investment Report[122] in 2022. The fragile growth of real investments were dropped down. The fallout of the war in Ukraine with the triple food, fuel, and finance crises, along with the ongoing COVID-19 pandemic and climate disruption, added stresses, particularly in developing countries. Germany, Italy, France, The Netherland were the top destinations within the EU27. The Commission continuously encouraged Member States to establish FDI screening mechanism, to be able to react the changing geopolitical situations. This initiation was successful, since national legislation or consultative processes were underway in the remaining Member States as well. The realized screenings are in numbers: 55% of the transactions were formally screened, and 86% out of them were authorized without conditions (9% of them were approved with conditions or mitigating measures, and 1% was blocked, and 4% were withdrawn by the Parties.) In 2022, 17 Member States submitted a total of 423 notifications (Article 6). Six Member States, namely Austria, Denmark, France, Germany, Italy and Spain, were responsible for more than 90% of the notifications.

[121] European Commission, Directorate-General for Trade, Third annual report on the screening of foreign direct investments into the Union, Publications Office of the European Union, 2023: https://data.consilium.europa.eu/doc/document/ST-14427-2023-INIT/en/pdf
[122] United Nations Conference on Trade And Development: World Investment Report, 2021 – investing in sustainable energy for all: https://unctad.org/system/files/official-document/wir2023_en.pdf

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