June 2018

ESF POSITION PAPER ON FRAMEWORK FOR SCREENING FDI INTO THE EU

Executive Summary of ESF Position:

- ESF believes that the proposal presented by the European Commission for screening Foreign Direct Investment into the EU - which will now be debated in a trilogue with the Council and the European Parliament - is a step in the right direction towards achieving a balanced approach between respecting legitimate security and public order objectives while maintaining an open FDI environment in the EU.
- As a question of principle, the European services industries strongly support the openness of the EU market to foreign direct investments
- Based on the importance of FDI to the EU, the ESF believes that the assessment of the impact of the proposed legislative procedure should be deepened.
- ESF advocates for a narrow and further clarified definition of security and public order to avoid different interpretations between different Member States.
- ESF supports the fact that the ultimate decision to allow, condition or block FDI lies with the Member State where the investment project is planned/completed.
- ESF takes note that services sectors are listed as "projects or programmes of Union interest" and calls for clearer definition of the notion of "critical infrastructures" as interpreted by the European Court of Justice.
- As for the sectors that should be screened, ESF believes that an overly detailed list might have a deterrent effect on Foreign investors who might hesitate to invest and innovate in the EU. We hence do not support the Parliament's amendments for a long and detailed list of sectors.
- ESF strongly supports the fact that the Member States and the Commission must guarantee the highest level of protection for confidential information transmitted by the investor candidate.

Introduction: The context

On 13 September 2017, at the occasion of the State of the European Union speech given by President Jean Claude Juncker to the European Parliament, the European Commission published a proposal for a Regulation *"establishing a framework for screening of foreign direct investments into the European Union" as well as other related documents*[1].

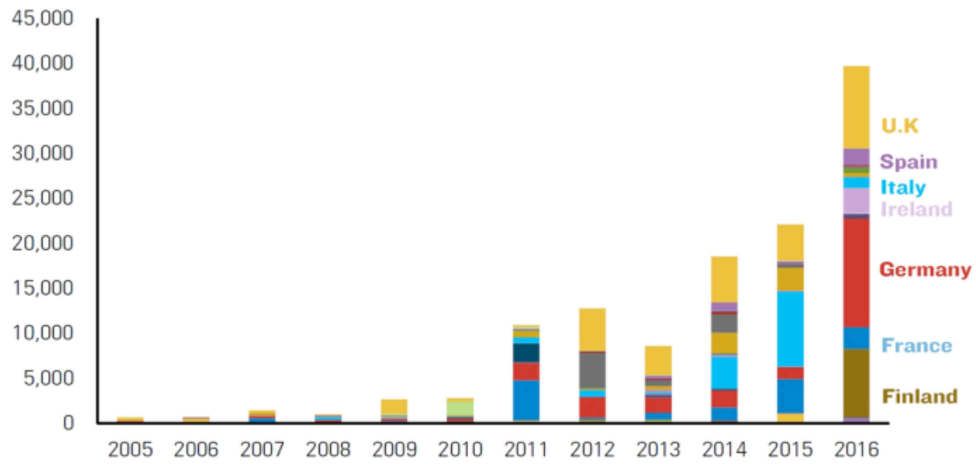
As a reminder, it is noted that at global level, FDI screening mechanisms exist in many of the EU's main trading partners, including Australia, Canada, China, India, Japan and the US. As for within the EU, 13 Member States already have in place FDI screening mechanisms, more or less strict, based on the grounds of defense and security. They are: Austria, Finland, France, Germany, Italy, Latvia, Lithuania, Luxembourg, Poland, Portugal, Spain, Sweden and the United Kingdom. These mechanisms use different procedures, different thresholds and different timelines for reaching decision.

In recent months, the debate on this issue came up in a more vocal manner, based on significant increase of Chinese investments in the EU and, more specifically, the question of acquisitions by

[1] https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-487_en

Chinese companies (private or State-Owned) of European companies in sectors deemed strategic, such as IT. Many will remember the case of the takeover of the German robot manufacturer Kuka by the Chinese private and listed company manufacturing white goods Midea.

One should emphasise however that the amount of China's direct investment in Europe is still at a relatively low level. Currently, only 0.6 percent of FDI stocks in the EU[2] (2016: 45.1 billion Euros) comes from China. The FDI stocks of EU investors in China, on the other hand, exceed this amount fivefold (2016: 177.7 billion Euros, 2.4 percent of the EU investment stocks abroad). However, the growth rates for Chinese investment in the EU have risen substantially in recent years (see chart). A close monitoring in the coming years will indicate whether the trend will continue at that path.



Data source: Rhodium Group, 2017.

According to a MerRICS' report, in 2016[3], Chinese FDI in the EU reached €35 billion, which translates into an increase of 77% in comparison to 2015. The bulk of Chinese FDI concentrated (around 59%) in France, Germany and the UK. In terms of sectors, between 2008 and 2016, industrial machinery and equipment, ICT, utilities, transport and infrastructure increasingly attract investments. However, it must be noted that these figures do not correspond to the Eurostat figures and must be interpreted with care. Eurostat reports in 2016 an Inward flow from China of €10.2 billion, and an Outward flow to China by the EU of €12.5 billion, with still a positive balance for the EU of €2.3 billion[4].

It is in this context that three EU Member States – namely Germany, France and Italy – addressed in February 2017 a clear request to the European Commission to work on a European instrument to *"prevent any damage to the economy through one-sided, strategic direct investment made by foreign buyers in areas sensitive to security or industrial policy, and to ensure reciprocity"*[5]. This request triggered a debate in the EU. In March 2017, the European Peoples' Party (EPP) at the European Parliament made a proposal for a Union Act on the screening of foreign investment in strategic sectors[6].

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[2] http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Top_10_countries_as_extra_EU-28_partners_for_FDI_stocks,_EU-28,_end_2012%E2%80%932015_(billion_EUR)_YB17.png

[3] *"RECORD FLOWS AND GROWING IMBALANCES: Chinese Investment in Europe in 2016" Report by Mercator Institute of China Studies – MerICS: http://rhg.com/wp-content/uploads/2017/01/RHG_Merics_COFDI_EU_2016.pdf*

[4] http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc_149251.pdf

[5] *See paper posted on German Federal Ministry of Economic Affairs and energy: https://www.bmwi.de/Redaktion/DE/Downloads/E/eckpunktepapier-proposals-for-ensuring-an-improved-level-playing-field-in-trade-and-investment.pdf?__blob=publicationFile&v=4*

[6] http://g8fip1kplyr33r3krz5b97d1.wpengine.netdna-cdn.com/wp-content/uploads/2017/03/2017-03-20-Draft-Union-Act-on-Foreign-Investment.pdf

1. The content of the Commission proposal

The purpose of the proposed Regulation is to set up a common framework for the screening of FDI into the EU, on the grounds of security and public order. It does not cover portfolio investments (Article 1 & 2). In addition, the Proposed regulation aims at establishing a closer cooperation among Member States and between Member States and the Commission in this area (Article 8).

More specifically, the Proposed regulation would allow EU Member States to maintain, amend or adopt FDI screening mechanisms under the condition that these mechanisms are: transparent and non-discriminatory; follow rules set on the triggering and actual process of screening; establish specific timelines within which screening can take place (Article 9); protect confidential information (Article 11) and offer foreign investors the possibility of judicial redress against screening decisions.

The Proposal also describes various factors which may be taken into account in the process of screening, including the sectors in which FDI takes place (critical infrastructure, critical technologies) as well as the security of supply of critical inputs, access to sensitive information, and whether the foreign investor is controlled by a government of a third country (Article 4).

The Commission proposal would instruct the Member States that have a screening mechanism in place to report annually to the Commission of the FDI that took place in their territory, and on the activities of their screening mechanism. Member States without screening mechanisms in place will also have to report on an annual basis on the FDI that took place in their territory (Article 7).

One of the biggest novelty of the Commission proposal is the possibility for the European Commission to screen foreign direct investments in the context of projects or programmes of Union interest (Article 3 & 9), listed in Annex I of the proposal for a Regulation, including European GNSS programmes (Galileo and EGNOS), Copernicus, Horizon 2020, Tran-European Networks for Transport (TEN-T), for Energy (TEN-E) and for Telecommunications.

Finally, the Proposal establishes a cooperation mechanism at EU level, in order to improve information among Member states and the institutions. It will operate on the basis of annual reports as well as on ad hoc basis, when Member States or the Commission request information to other Member States in cases where they consider that an FDI may pose a threat to their security of public order, or to this of the EU. Member States would also have to inform the Commission and other Member States of FDI projects for which a screening is performed by their national mechanisms. Furthermore, EU Member States will also have the possibility to provide comments to another Member State if they consider that a planned or completed FDI in that Member State is likely to affect their security or public order (Article 8.4). The Commission may also issue an Opinion if it considers that a planned or completed FDI is likely to affect security and public order in one or more Member States. The Member States that would receive these comments or opinions would be invited to give due consideration to these comments or Opinions, but the final decision on the FDI remains always in their hands (Article 8.6). However, they will have to provide an explanation to the Commission and the Member State in case its opinion is not followed (Article 9.5). ESF also notes the request to each EU Member States to appoint a "foreign direct investment screening contact point" (Article 12), who will follow the implementation of the regulation.

2. European Parliament preliminary reaction

It is important also to take into consideration the Report of the European Parliament on this file, which was adopted in plenary on 4th June 2018. The Report led by Mr. Proust (EPP – FR), Rapporteur of INTA Committee in the European Parliament[7], is notably making the following proposal for amendments to the Commission's Proposal:

- long extension of the sectors to be screened (see Amendments39-43);
- stricter control rules (see Amendment44);
- the possibility to ask the Member State concerned by the investment to "take utmost account of their comments and the opinion of the Commission and provide a written explanation" if at least a third of EU Member States expressed concerns over such a FDI. The Amendment continues: "Where those comments or opinions are not followed, the Commission shall foster dialogue between the Member States having issued comments and the Member State in which the foreign direct investment is planned or has been completed". (see Amendment 62);
- The creation of an "Institution-based contact points and coordination group on foreign direct investment screening" (see Amendment78-82).
- The possibility for businesses ("Economic operators") and other players to be invited to communicate their experience (see Amendment 82).

As an additional information on the subject, the European Economic and Social Committee has adopted its Opinion on the Proposal for Regulation on 19 April 2018[8].

3. ESF Position on the Proposal

As a question of principle, the European services industries strongly support the openness of the EU market to foreign direct investments. FDI is a source of growth in the EU countries, which in turn contributes to innovation and competitiveness. An analysis[9] of the EU-28's international investment position at the end of 2014 reveals that the services sector — defined as financial and insurance activities; professional, scientific and technical activities; distributive trades; information and communication; administrative and support service activities; real estate activities; transportation and storage; accommodation and food service activities — accounted for 87.4 % of its inward investment, which is very significant.

FDI is also a strong source of significant employment in the EU. The Commission estimated in its October 2015's Communication "Trade for all – Towards a more responsible trade and investment policy" that inward investment is responsible for employing 7.3 million people in the EU"[10]. We believe however that this figure is strongly underestimated. According to Eurostat, foreign controlled companies in the EU countries in 2014 employed around 15% of total employment. According to ILO, 72% of total employment in the EU28 is working in the services sectors, which would mean that approximately 25 million of workers in the EU are working in foreign controlled services companies thanks to inward FDI.

The European Services Forum is committed to ensuring, though trade and investment negotiations, better openness of third markets to EU services providers/investors also known as the Mode 3 of the GATS ("commercial presence abroad").

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[7] REPORT on the proposal for a regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union (COM(2017)0487 – C8-0309/2017 – 2017/0224(COD)) Committee on International Trade Rapporteur: Franck Proust

[8] https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/screening-foreign-direct-investments-european-union

[9] http://ec.europa.eu/eurostat/statistics-explained/index.php/Foreign_direct_investment_-_stocks

[10] Trade for all – Towards a more responsible trade and investment policy, European Commission, October 2015 – page 9 - http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf

It is in this context that ESF analyzed the Commission Proposal for a Regulation "establishing a framework for screening of foreign direct investments into the EU" and believes that it took the sensible approach by suggesting an information sharing mechanism at EU level, although technical clarification to ensure sufficient protection of the sensitive information from companies will be needed.

First, based on the importance of FDI to the EU, the ESF believes that the assessment of the impact of the proposed legislative procedure should be deepened. For example, the effects of a possible rejection of FDI projects and the potential impact on the EU attractiveness as an FDI destination needs to be thoroughly assessed and considered.

Second, ESF welcomes the strong affirmation in the Proposal of the principle of openness of the EU market to foreign direct investments. ESF believes that any framework established to screen investment should ensure that its mechanisms are proportional, non-discriminatory and in line with the EU's international obligations (notably the WTO and the GATS) and the rules of the Single Market. The functioning of these mechanisms should be transparent, with clearly defined criteria, and its scope should be limited to screening foreign direct investment on the grounds of security or public order.

In this regard, ESF advocates for a narrow and further clarified definition of security and public order to avoid different interpretations between different Member States. This is important to ensure a harmonious implementation within the EU. If a broad definition is adopted, member states could be tempted to define relocation of jobs as a threat to security and public order. Consequently, too many investments will be screened, which will be burdensome to the business community and deter productive FDI.

ESF supports the fact that the ultimate decision to allow, condition or block FDI lies with the Member State where the investment project is planned/completed. This is important to ensure the sovereignty of the Member States over the investments which take place on their territory. The framework will allow them to use as they see fit the information, knowledge, questions or analyses of the other Member States and/or of the European Commission to take their sovereign decision to authorise, prohibit or to modulate an investment through transitional or flanking measures. Any screening process must respect a short time line, and the end decision must provide long term legal certainty to the investors. The EU cannot run the risk of losing investments due to uncertainty triggered by the screening framework. Foreign direct investment is highly mobile and the EU faces global competition to attract it. FDI is essentially driven by trust, which is a loose notion that is hard to determine and easily undermined. In the last five decades, the EU has been a strong magnet of FDI, which has driven growth, employment and innovation in the EU. This must remain the case.

There is a proposal for a direct involvement of the European Commission in screening investment projects of "Union interest on the grounds of security or public order" (Article 3.2). The objective is to target infrastructure and other projects where "substantial amount or a significant share of EU funding, or which are covered by Union legislation regarding critical infrastructure, critical technologies, cyber inputs" (See Article 3[11]). The notion of "security or public order" is interpreted by the European Court of Justice as a competence of member states. It would be therefore important to provide clarification on the scope of competences in this specific case.

As regards the "projects or programmes of Union interest", sectors covered by the Proposal include infrastructure, energy, transport, communications, data storage space or financial infrastructure,

[11] An indicative list of projects or programmes of Union interest is included in Annex I to the Proposal.

"sensitive facilities", artificial intelligence, robotics, semiconductors, dual use technologies, cyber security, space or nuclear technology, supplies of critical raw materials, and any project that involves "access to sensitive information or the ability to control sensitive information" (see Article 4). We note that the Commission has drawn attention to the fact that the notion of "critical infrastructures" is already defined in many EU Directives, and has been interpreted rather restrictively by the European Court of Justice. For the sake of clarity and certainty, ESF would support the inclusion of adequate references in the regulation. We take note that many of these listed sectors are services sectors.

We also take note that, although the list by the Commission is non-exhaustive ("inter alia"), the European Parliament Report has increased significantly the sectors that should be screened, including numerous new services sectors (Amendment 39 :"[…] transport networks, ports, rails, airports and shipyards, transport services, communications and media, aerospace and space infrastructure, data storage facilities, large-scale data analysis, election-infrastructure, financial services infrastructure as well as sensitive facilities"; Amendment 340: "critical and strategic technologies, including, inter alia, artificial intelligence, robotics, quantum technology, nano-, bio- and medical technologies, information and communication technologies (ICTs), …"; Amendment42: "access to sensitive information or to the personal data of Union's citizens, including, inter alia, personal data concerning health, and the ability to control large-scale or sensitive information").

ESF believes that an overly detailed list might have a deterrent effect. Foreign investors might hesitate to invest and innovate in the EU, especially in emerging technologies if there is a risk that the EU framework for Screening of FDI might change their conditions, possibly some time after their investment. Investors need strong legal certainty. We would like therefore to support the Commission approach on this Article 4.

ESF strongly support the fact that, given that some of the information transmitted between an investor candidate and a Member State may be highly confidential, it must be clearly stated that in the framework of the exchange of information set by the framework for screening, the Member States and the Commission must guarantee the highest level of protection for that information. Given the diversity of legal systems in the EU and the divergences of interpretation of "confidentiality" in various Member States, ESF is worry of the weakness of the language in Article 11 of the Proposal for the Regulation and would like to call for a stricter "confidentiality procedure".

It must be acknowledged that the national instruments already existing in some Member States cannot guarantee reciprocity and fair competitiveness. Such objective can only be achieved through trade and investment policy driven at the EU level. ESF therefore welcomes the fact that the Commission did not refers to reciprocity in the proposed Regulation. We take note however that the INTA Report suggests the introduction of criteria such as whether or not "access to the sector in the foreign investor's country of origin is open, restricted or banned and there is no reciprocity or a level playing field" (see Amendment 35). ESF would like to urge the EU legislator not mix up its policy tools. We however call upon the Commission to keep in mind the lack of reciprocity for EU investors in many countries with which the EU is currently negotiating and to make its utmost efforts to open these markets to EU investors in the appropriate way.

List of ESF Members Supporting the above Position

1. Accountancy Europe
2. Amfori
3. Architects' Council of Europe –ACE
4. British Telecom Plc
5. BDO
6. Bureau International des Producteurs et Intermédiaires d'Assurances – BIPAR
7. BUSINESSEUROPE
8. BUSINESSEUROPE WTO Working Group
9. Danish Shipping
10. Deutsche Telekom AG
11. Deutsche Post DHL
12. DI – Confederation of Danish Industries
13. Digital Europe
14. EK - Confederation of Finnish Industries
15. EuroCommerce
16. European Banking Federation - EBF
17. European Broadcasting Union - EBU
18. European Community Shipowners' Associations – ECSA
19. European Express Association – EEA
20. European Federation of Engineering and Consultancy Associations – EFCA
21. European Public Telecom Network – ETNO
22. European Savings Banks Group – ESBG
23. European Satellite Operators Association - ESOA
24. European University Association - EUA
25. Fédération de l'Industrie Européenne de la Construction – FIEC
26. IBM Europe, Middle East & Africa
27. Inmarsat
28. Insurance Europe
29. Irish Business and Employers' Confederation - IBEC
30. Le Groupe La Poste
31. Microsoft Corporation Europe
32. Mouvement Des Entreprises Françaises - MEDEF
33. Oracle Europe, Middle East & Africa
34. PostEurop
35. SELDIA – European Direct Selling Association
36. Svenskt Näringsliv (Confederation of Swedish Enterprise)
37. Telenor Group
38. The CityUK
39. Thomson-Reuters
40. UPS
41. Zurich Financial Services