SHIELDING OPEN MARKETS FROM CORROSIVE CAPITAL

A TAKE ON THE VARIOUS FDI SCREENING REGIMES AND A WAY FORWARD

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REPORT

EUROPEAN VALUES CENTER FOR SECURITY POLICY

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Keywords:

- **Corrosive capital** is financing, whether state or private, that lacks transparency, accountability, and market orientation. Originating from authoritarian regimes, corrosive capital exploits and exaggerates governance gaps to influence economic, political, and social developments in recipient countries (CIPE, n.d.) or to pursue their foreign policy agenda and advance their political and economic influence (Manhit, 2021).
- **FDI screening mechanism** is the process whereby a foreign investment recipient government identifies, reviews, and if necessary, rejects investments emanating from abroad. These mechanisms give recipient governments greater control over national security-threatening and other potentially problematic foreign investments (PSSI, n.d.). Specifically, they aim to safeguard against the inflow of corrosive capital to sensitive industries, especially if the capital is from foreign state-controlled or state-influenced investors, which can ultimately negatively impact the targeted economy, national security or public order.

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EXECUTIVE SUMMARY

- Over recent years in the West, there have been mounting concerns over the persistent undue and unwanted **technology transfer** and outflow of know-how from **sensitive or strategic sectors** of national economies.
- These concerns are linked to **national security** and **public order** considerations, as well as to **unfair competition** and **predatory practices** from rival countries, such as the People's Republic of China, which may harm the domestic industrial base and long-term global **competitiveness** in strategic sectors, and hence future economic prosperity.
- Chinese foreign direct investments (FDI) include acquisitions of **strategic infrastructure** as well as smaller investments aimed at acquiring **cutting-edge technological know-how**.
- The **Chinese government** directs and/or unfairly facilitates the systematic investment in, and/or acquisition of, companies and assets by Chinese companies to **obtain cutting-edge technologies** and intellectual property and generate large-scale technology transfer in industries deemed important by the Chinese government's **industrial plans**.
- To address these threats, Western countries are implementing various **economic security** policies to protect their independence, survival, and economic prosperity.
- These countries are especially **tightening oversight** to prevent FDI targeting sensitive technology and shielding their economies from corrosive capital inflows through the establishment or reinforcement of **FDI screening mechanisms**.
- **The US** has been an influential actor in the debates on FDI screening and its **CFIUS** process serves as a model for other countries.
- While many countries have **strengthened** their FDI screening regimes as regards emerging technologies, e.g. Japan by **lowering** the threshold for which prior approval must be sought for FDI in sensitive industries, **Germany** went the other way and **raised** the threshold allowing more FDI in emerging technologies to avoid screening.
- **In the EU**, the **absence** of FDI screening mechanisms in individual member states represents a **vulnerability** for the single market. Therefore, all member states need to **have in place** robust national screening mechanisms, and lax screening regimes must be **strengthened**.
- Moreover, enhanced **dialogue** between state authorities and the private sector would help the business community to see and understand FDI screening as a **legitimate tool** used by the government to protect the economy against corrosive capital and foreign predators, while reassuring that the door remains open to constructive capital.

- The FDI screening mechanism may act both as a **deterrent** against corrosive capital inflows and as a tool for providing a degree of **certification** of a company's clean and sound capital structure and ownership, which in turn may help it access other developed markets.
- The governments need to carefully distinguish between **legitimate protection** of the economy and **unjustified protectionism**.
- **Protectionist practices** such as shielding national champions from fair competition should be **avoided** as much as possible as they could undermine the economy's long-term competitiveness.
- Advanced countries would benefit from initiating a conversation about how to regulate **outbound investment** to avoid transferring sensitive technology which could pose a threat to national security.

INTRODUCTION

In the economic domain, the objectives of national security should be to ensure that a country's supply chain is generally in friendly hands, reducing vulnerabilities and over-dependence (Shastry, 2022). These are some of the aims of the economic security policies that are gradually being strengthened and reinvented across the globe. Economic security includes the regulation of trade and investment, as some Foreign Direct Investments (FDI) may indeed pose a security or public order risk.[1] This is the key premise of the FDI screening mechanism and the recent increased scrutiny of foreign takeovers.

FDI screening is one of the main pillars of national economic security. It aims to safeguard against the inflow of corrosive capital to sensitive industries, especially capital from foreign state-controlled or state-influenced investors, which can ultimately threaten national security or public order and disrupt the sound functioning of the economy. Implementation and review of FDI screening mechanisms are now accelerating in the EU and across the world in light of the PRC's increasingly hostile foreign and economic policies.

The purpose of this paper is to outline the main aspects of various FDI screening mechanisms and details of and behind the respective national policies to serve further policy debates and potential policy updates.

CONCERNS OVER ACQUISITIONS OF TECHNOLOGIES

There are two main factors that prompted the FDI screening policy to become a flagship of many nations' economic security agenda. One is the COVID-19 pandemic that exposed weaknesses in supply chain reliability and the resilience of many nations, especially in the medical and healthcare industries. The other is the PRC's rise, accompanied by massive outward investments by state-owned and private firms in sensitive and non-sensitive sectors (Shastry, 2022).

A combination of these two factors also underlined the concerns about predatory acquisitions of weakened companies and strategic assets during the pandemic crisis, especially by foreign state-owned enterprises (SOEs). Also, the concerns about a wide range of unfair practices of the Chinese government (and the Chinese Communist Party (CCP)) related to technology transfer, intellectual property, and innovation are longstanding.

Chinese FDI includes both state and private acquisitions of strategic infrastructure as well as smaller investments aimed at acquiring cutting-edge technological know-how (Rasmussen Global, 2017). The US government's investigation found that the Chinese government directs and/or unfairly facilitates the systematic investment in, and/or acquisition of, US companies

1 Also, obtaining sensitive technology or information by malign actors could ultimately jeopardize international peace (Suzuki, 2021).

and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and generate large-scale technology transfer in industries deemed important by Chinese government industrial plans (USTR, 2018). In the EU, Chinese FDI is focused on acquiring EU brands, know-how and cutting-edge technology firms. A clear focus has been set on advanced industrial machinery and equipment, ICT, utilities, transport and infrastructure, and energy (EPRS, 2017), more recently on critical infrastructure and strategic dual-use technologies (e.g. semiconductor producers) and new emerging sectors of e-commerce, FinTech, gaming, artificial intelligence (AI) and robotics (MERICS, 2022). Japan is also increasingly worried by the evidence of persistent technology outflow to China (Tatlow & Herr, 2022).

One driving force behind Chinese acquisitions of Western technology has been the country's dual-circulation development model aiming to achieve a civil-military integration of technology, known in Western regulation terminology as "dual-use" technology. Other factors behind the Chinese acquisitions have been the PRC's 13th five-year plan (2016-2020) and the "Made in China 2025" strategy which aims to create 'national champions' in 10 high-tech manufacturing sectors. The PRC is thus trying to gain the upper hand in technological innovation through mergers and acquisitions (M&A) (Irwin-Hunt, 2022), thus aiming to reach the ambitious goal of technological supremacy.

FDI SCREENING: COMPARISON BETWEEN DIFFERENT COUNTRIES

To tackle the concerns highlighted above, many Western countries have put in place FDI screening mechanisms to review and potentially ban problematic FDI in their domestic companies. Below, the key aspects of the FDI screening mechanisms in the US, EU, Japan, and Taiwan are outlined.

FDI Screening in the US

The US has been perhaps the most influential actor in the debate over inbound FDI screening regimes within the OECD and alongside Australia and Canada, is a pioneer in its early introduction (US-China Investment Project, 2022). The vetting process of certain transactions involving FDI with national security implications is carried out through the interagency Committee on Foreign Investment (CFIUS), initially established in 1975 to study foreign investments and since 1988 empowered to reject deals. The FDI review was initiated if the transaction resulted in foreign "control" of a US business that may pose a threat to national security. The concept of "national security" was purposefully not defined to allow CFIUS maximum flexibility in determining the outcome of a transaction (Tzinova, 2020).

In 2018 (in effect from 2020), the Foreign Investment Risk Review Modernization Act

(FIRRMA) modernized and strengthened CFIUS to address national security concerns more effectively. Particularly, FIRRMA expanded the jurisdiction of the CFIUS to review also "other" – non-controlling FDI in US companies that involve critical technologies, critical infrastructure, and sensitive personal data.[2] FIRRMA also expands the CFIUS jurisdiction to certain real estate transactions, particularly to real estate located within a certain range of military installations and other government facilities, airports or maritime ports.

CFIUS is chaired by the US Treasury Department and includes other members such as the Department of State, Commerce or Defense. If CFIUS determines that a transaction presents national security risks, it may enter into an agreement with, or impose conditions on, parties to mitigate such risks or may refer the case to the President for decision. Acting on recommendation from CFIUS, the President will approve, reject, or conditionally approve the transaction. The President is the only CFIUS officer with the ability to suspend or prohibit transactions and can order foreign companies to divest holdings in US companies.

In addition to reviewing inbound investments, there are efforts underway in the US Congress to introduce an outbound CFIUS process. According to a leading proposal in the US, an interagency committee led by the Office of the US Trade Representative would screen and potentially block transactions by US businesses in 'countries of concern' (foreign adversaries and those with non-market economies) and where 'national critical capabilities' are at stake. This is again driven by concerns about a loss of visibility into supply chains, the transfer of sensitive technologies, and the outsourcing of critical production. Especially that investment in the PRC facilitates the transfer or buildup of technology and know-how that could strengthen Chinese civil and military capabilities to the detriment of the US. These concerns are further amplified by the existence of civil-military fusion[3] programs and the near impossibility of keeping Chinese firms' homegrown technology away from the military (US-China Investment Project, 2022).

FDI Screening in the EU

In 2016, the flow of Chinese FDI into the EU reached an all-time-high. Chinese FDI was mainly driven by market-seeking and strategic asset-seeking motives and focused on big EU economies, and mainly targeting cutting-edge technologies (EPRS, 2017). This same year, it became apparent to most EU member states, that the existing FDI review procedures will need to be updated to tackle concerns about potentially risky investments from third countries, and the 'unfair competition' from China, which may harm the EU's industrial

2 Such non-controlling FDI would be those that grant foreign investors access to material non-public technical information or substantive involvement in the US business's decision-making with respect to the technology, infrastructure or data (Tzinova, 2020).

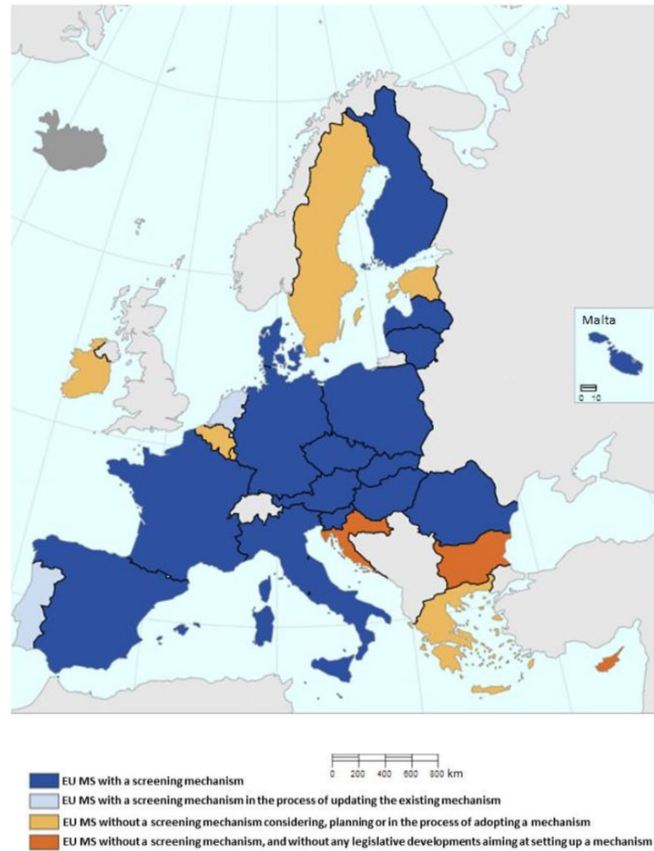
3 According to the PSSI Glossary, civil-military fusion is a Chinese official policy promoting interaction between the PRC's military and law enforcement and its research and development (R&D) and commercial enterprise sectors. In effect, it is a mechanism ensuring Chinese state access to, and control over, all technological advancements and other innovations in the country for the purposes of defense procurement, whether they originate from public or private enterprises (PSSI, n.d.).

base, long-term global competitiveness in strategic sectors, and hence its future economic prosperity (EPRS, 2017).

The EU's FDI screening framework was implemented in October 2020. Nonetheless, the FDI screening itself remains a national competence of member states. Since 2020, the EU-wide FDI screening regulation has only required member states to report their national screening activities to the European Commission and other member states. The Commission can then issue a non-binding opinion about the risk of certain FDI transactions (which the member states can choose to ignore). Effectively, Brussels cannot directly block any investment, only EU member states alone can. So the EU framework provides more of a notification platform for exchange of information for those member states that decided to establish their own national mechanisms. Consequently, the scope of sectors and technologies to which the mandatory screening applies varies across member states and is therefore not uniform.

Currently (May 2022), 16 out of 27 EU member states have their FDI screening mechanisms fully implemented. Others should follow; in particular, two are in the process of updating their existing mechanisms (Netherlands and Portugal) and six (Belgium, Estonia, Greece, Ireland, Luxembourg and Sweden) are planning or are in the process of adopting a new mechanism. Only three (Bulgaria, Croatia and Cyprus) currently do not have serious plans to adopt one (European Commission, 2021).

EU member states with(out) FDI screening mechanisms



Source: European Commission (2021)

During 2020, the framework's first operational year, EU member states reported that they obtained 1,793 FDI cases (investment dossiers) for approval. Of these, about 80% were not formally screened due to ineligibility or clear irrelevance to security or public order. Only 20% underwent formal screening, of which about 79% were authorized without conditions, 12% with conditions, and only 2% prohibited, with 7% aborted in the process (European Commission, 2021).

The scrutiny on foreign investors may have deterred some from making deals in the EU. Indeed, deals by PRC-based investors in the EU fell by 63% in 2020. Yet this decline has likely been due to other reasons, mainly the impacts of the global COVID-19 pandemic and China's tighter restrictions on outbound capital flows. Still, the PRC, with 2.5% (down from 4% in 2019), was the fourth foreign investor in the EU in 2020 (European Commission, 2021). Despite intensifed scrutiny on strategic technologies, some Chinese deals are still being approved in the EU. For example, in April 2020 Germany allowed Chinese CRRC to acquire Kiel-based locomotive business Vossloh (Irwin-Hunt, 2022). Others may slip under the radar, as with the case of Italian Alpi Aviation (Ghiretti, 2022).

In the EU's decentralized framework, loopholes certainly exist. Foreign enterprises can enter the single market via EU member states with no or very lax screening mechanisms, and then compose a net of ownership that will make it very difficult to identify them as foreign enterprises – for example, Luxembourg is known for the proliferation of such "Europeanization" practices thanks to the numerous Chinese banks in the country (Ghiretti, 2022); and Denmark, motivated by ensuring as broad an investor base as possible, excluded start-ups from the screening for the first five years of their existence. Such practices may turn out to be risky.

FDI Screening in Central Europe

Two examples from Central Europe, the Czech Republic and Germany, demonstrate different paths in FDI screening regulations taken by the two neighboring EU member states.

The FDI screening mechanism in the Czech Republic, in effect from 2021, is in many ways similar to the US model. The final decision about approving, conditionally approving, or rejecting FDI considered risky is done at the highest political level, that is, in the Czech case, by the government. For military material, selected dual-use items, or critical (information) infrastructure, the foreign investor has to request prior mandatory authorization. As in the US, it is at the discretion of the authorities to review ex officio any transaction ex-post. The scope is determined by the ultimate potential threat to impair the national security, and – in the Czech case – also the public order. This seemingly overreaching discretion is compensated by the possibility for the contracting parties to pre-consult the FDI authority on the likelihood that their transaction can become subject to the ex-post review. This provision is intended to increase legal certainty. The threshold for considering the transaction an FDI is 10 percent of the voting rights.

In Germany, the threshold for FDI is a 10 percent level and it applies across the board. But in 2021, Germany raised the FDI threshold to 20 percent for specifically defined emerging technologies (including AI, robotics, semi-conductors, optoelectronics, quantum and nuclear technologies). This was a political decision led by the country's desire to attract foreign capital for its start-up sector and also due to pressure from businesses (Tatlow & Herr, 2022).

In April 2020, Germany allowed Chinese CRRC to acquire Kiel-based locomotive business Vossloh (Irwin-Hunt, 2022), while it failed to approve a bid by Taiwan's GlobalWafers – a manufacturer of silicon wafers – to purchase its German peer Siltronic (Shead, 2022). Such cases raise concerns about countries rather seeking technological sovereignty and strategic autonomy, even among like-minded partner jurisdictions, than shielding the economy from corrosive capital used by nefarious investors originating from authoritarian states.

FDI Screening in Japan

Japan has had an FDI screening mechanism in place since 1949. The FDI rules in Japan are included in the Foreign Exchange and Foreign Trade Act (FEFTA) and related ministerial ordinances (Murata & Oide, 2022). The competent ministries screen the FDI to determine if it is likely to impair national security, public order, or the public safety or have a significant adverse impact on the smooth operation of the Japanese economy. The screening procedure is two-staged. The first line of screening is done by the Ministry of Finance and relevant ministries such as the Ministry of Economy, Trade and Industry (METI), upon notification by the investor through the Bank of Japan. If the ministries find the transaction to be dubious, it is referred to the Council on Customs, Tariff, Foreign Exchange and other Transactions.

Recently, Japan has made several amendments to FEFTA which are aimed at strengthening investment restrictions in certain sensitive sectors. Although Japan has designated 16 industrial domains – including arms, space, cyber, water, electricity, the rail network, and oil refining – which are on the negative list for FDI, wider economic security considerations prompted the authorities to further tighten screening in the updated legislation (Shastry, 2022).

In November 2019, Japanese Diet approved stricter investment restrictions; it lowered the general threshold for which prior approval must be sought for foreign investments in designated sensitive industries (core companies involved in national security), from 10 percent to 1 percent, with some accompanying exceptions to the rule.[4] This change was made to align the threshold with the Japanese law allowing an investor to make formal proposals (especially nominating) at a shareholder meeting if they hold just a 1 percent stake.

The government has also strengthened the enforcement system for investment screening and post-transaction monitoring under FEFTA, and enhanced the management and supervision of investments made by foreign capitals. The scope of "deemed export" under FEFTA will be clarified, and the range of control will be expanded to residents under foreign influence to prevent the leakage of sensitive technology (effective May 1, 2023). The post-monitoring system is important in deterring the intervention of foreign governments.

Similar to the US FIRRMA, Japan in 2021 introduced a notification scheme for land purchases. Through the Important Land Survey Act, it requires prior notification (with the nationality of the buyer and purchase purpose stated) for land purchases within one kilometer of installations of critical infrastructure belonging to the US and Japanese

4 Investors posing relatively low risks are exempted from the prior-notifications requirements, even for the core sectors. For example, securities firms, banks, insurance companies, asset management firms, trust companies, registered investment trusts and registered high-frequency traders who are already bound by financial regulatory laws have a "blanket exemption". One of the conditions for exemption is that investors will not access non-public information about the invested company's technology that could impact national security (Yamada & Sasaki, 2020).

militaries or the coast guard, areas bordering or facing international waters, and uninhabited or remote islands.

As regards the outbound screening regime, Japan requires government notification by Japanese residents for foreign investment in a small number of industries for security reasons, in particular outbound investment in fisheries or firms involved in the manufacture of weapons, narcotics, and leather goods (US-China Investment Project, 2022). Nonetheless, the screening of outbound investment in Japan was established in a completely different context than economic security.

There are concerns that Japan as a country known for cozy and sometimes collusive relationships between industry and government, can use the new powers to limit the foreign investors' rights regardless whether they pose an actual security threat. For example, in 2020, METI used FEFTA provisions to intervene on behalf of Toshiba's top management to block proposals by overseas-based activist shareholders. METI's rationale was that averting the break-up of Toshiba was a matter of national security (Suzuki, 2021). This again may raise concerns that the FDI regulations may not be used to ensure economic security but rather to protect national champions.

FDI Screening in Taiwan

The FDI screening mechanisms in the EU and beyond are generally designed to be neutral, that is, they are applied to investments from all non-EU countries (not just the PRC). Taiwan is an interesting case in this regard. There, FDI screening regime has specific restrictions explicitly targeting the PRC, regulating them more strictly than other foreign investors. Taiwan only allows Chinese investors to own up to 30% of Taiwanese companies in sectors ranging from semiconductors and electronics components to solar energy. There are strict regulations targeting PRC investors owning Taiwanese companies in sensitive sectors, whether owned directly or indirectly through third-party entities. Furthermore, Taiwan's Investment Commission does not only examine the board of directors of a foreign company, but also whether there is a decision-making team and whether Chinese investors are involved. If this is the case, the company is considered a Chinese company, not a foreign company (Li, 2020).

Taiwan has identified its strategic high-tech goods (SHTGs) that are subject to special regulations. Under the Taiwanese Foreign Trade Act, export restrictions apply to these SHTGs (in addition to military equipment and dual-use items); they cannot be exported without permission, and the recipients must be screened against the country's Entity List (TW Ministry of Economic Affairs, 2017; TW Ministry of Economic Affairs - BFT, n.d.).

Deterring vs. Legitimizing effects

Scrutiny on foreign investors may function as a deterrent. When such review procedures for potentially risky FDI are in place, investors with malign motives may decide not to pursue the intended FDI at all, thus not entering the statistics of FDI deserving scrutiny or FDI having been banned. This may relieve the state authorities from burdensome monitoring and reviews as well as keeping the perpetrators from even trying their luck.

The downside is that this deterrent aspect of the FDI regimes may have negative effects on constructive capital (as opposed to corrosive capital) seeking to enter the economy and contributing to economic development. Instead, the existence of FDI screening may contribute to the perception of the country as having a less welcoming investment environment for foreign investors or as posing a higher risk to the investment itself.

Therefore, the state authorities need to engage in sincere and transparent dialogue with the business community explaining the procedures, as well as providing relevant clauses in the legislation alleviating the perception of potential risk that a constructive investment might be banned. For example, by an ex-ante consultative process with the investors, as in the US or the Czech Republic. The end goal of the interaction between state authorities and the private sector is for FDI screening to be seen and understood by the business community as a legitimate tool used by the government to protect the economy against corrosive capital and foreign predators, while reassuring that the door remains open to constructive capital.

In that sense, another positive step could be to promote the FDI screening as a procedure granting a kind of certification. Once screened, a foreign company may use the positive result as a guarantee of its clean and sound capital structure and ownership, which in turn may help it access other developed markets in countries that attach considerable importance to the integrity of supply chains (CZ Ministry of Industry and Trade, 2021).

International Cooperation

Not only cooperation at the national level between the state and business community is important. Greater cross-border cooperation and harmonization of screening rules are needed as well to ensure that in non-sensitive sectors, countries are operating on a level playing field and protectionist impulses are curbed. This can be achieved i.a. by mutual recognition of FDI rules (Shastry, 2022). Also, gathered intelligence on foreign investors can be shared among the partner FDI screening offices if trust is developed through long-standing cooperation.

Cooperation is also warranted in terms of policy inspiration and relating updates. In particular,

the new screening mechanisms emerging across the EU could benefit from the substantial US expertise and even personnel training. Information about nefarious investors, best practices and lessons learned should be shared among cooperating FDI screening offices within the EU, across the Atlantic, and with the other like-minded partner countries.

Maintaining Open Market Principles

Certainly, democratic allies and partners should avoid using protective tools, such as the FDI screening mechanism, against each other to protect their national champions, instead of tightening scrutiny of investors from risky jurisdictions with covert non-commercial agendas. Unfortunately, this could have been seen in the case of the first FDI prohibition by the French mechanism – a ban of the US industrial group Teledyne's plan to buy Photonis (Irwin-Hunt, 2022), as well as in the case of Germany's failure to approve a bid by Taiwan's GlobalWafers to purchase Germany's Siltronic.

This more restrictive approach points to the need to carefully distinguish between legitimate economic protection on the one side, and to erecting barriers to protect the national champions on the other. The latter approach, if used excessively and in unnecessary cases, can make the local investment environment unpredictable and difficult for international investors to cope with, consequently undermining the economy's potential and long-term competitiveness.

The key is to uphold open market principles while developing smarter measures in order to avoid seeing those same principles being turned into a strategic vulnerability (Rasmussen Global, 2017). Therefore, the FDI screening mechanisms need to be fine-tuned in a way to be reassuring that the door remains open to constructive capital and to ensure that the country is still able to promote and attract beneficial foreign investment.

Closing the Loopholes

The disclosure of the ultimate beneficial owners (UBOs) is one of the greatest challenges in screening FDIs. With their identities obscured, the knowledge of a given source of corrosive capital is obscured too. Therefore, sufficient resources and investigative capacities need to be ensured for the FDI screening offices to function adequately. Nonetheless, since there are myriad ways to conceal UBOs, specialized legal expertise combined with relevant information access is needed to ultimately identify malign sources of capital. Specialized private companies, be they financial, legal, or audit firms, may have the needed expertise when corporate law and registrations are concerned, and could serve as effective partners for the job, if the screening authorities wish to enhance their capacities on revealing UBOs.

In the EU, loopholes in the decentralized framework need to be closed. In order not to let foreign malign actors circumvent the rules and enter the single market via weak spots, all member states need to have in place robust national screening mechanisms and lax FDI

screening regimes need to be strengthened. The remaining few member states should be encouraged to rapidly adopt such a mechanism. Otherwise the absence of FDI screening mechanisms in several EU member states represents a vulnerability of the single market that might be exploited.

Individual countries should also make a concerted effort to map inbound investments so that no potential risk is overlooked. For example, line ministries should take up the responsibility of proactively monitoring their areas of interest and notify the screening authority if they detect dubious transactions (or they could even be empowered to initiate the screening themselves).

Outbound Investment Screening

Like the US, the EU and other advanced countries would benefit from beginning a conversation about how to regulate outbound investment and joint ventures between their and Chinese enterprises that develop technology that potentially poses a threat to national security (Ghiretti, 2022). Such a regime would go beyond the existing economic security policy tools and national systems of export control on military and dual-use items.

Of the ten largest OECD economies, only the Republic of Korea (ROK) and Japan have such restrictions in place. Korean legislation established the Industrial Technology Protection Committee with the ability to block outbound investment by firms that hold "national core technology" developed by government subsidies for R&D. Japan requires notification for foreign investment in a small number of industries for security reasons. In the US a respective legislative proposal is under consideration in the Congress.

It is likely that advanced countries will eventually pursue this path and implement outbound investment screening too. This regime should be clearly defined and targeted, and its implementation well-coordinated among partner countries to avoid putting individual ones at a competitive disadvantage (US-China Investment Project, 2022).

As a first practical step, some countries that have only recently established their new FDI screening regime should ensure it is firmly aligned with the national export control regime.

CONCLUSION

The increasing ease of transferring sensitive technology in the information age and the relating risks for national security makes a strong case for the introduction of protective mechanisms in national economies. One important pillar of economic security policy is the regulation of FDI in sensitive domestic industries. If properly designed, FDI screening mechanisms may serve as an efficient tool to prevent corrosive capital from entering the domestic economy.

Recently, several advanced economies bolstered their relevant regulations. The US has modernized and strengthened its CFIUS regime to more effectively address national security concerns, mainly those related to China and technology. Japan has lowered the threshold for which prior approval must be sought for FDI in sensitive industries and strengthened the post-transaction monitoring. Amid concerns about technology transfer and foreign predatory takeovers with a political rather than commercial agenda, the EU has reacted too, by establishing a coordination mechanism between member states.

However, in the EU, the responsibility to review transactions still rests at the national level and the practices are diverging across the community. Furthermore, not all member states have introduced solid mechanisms to function as effective shields of the national economies. Some member states have not established any mechanism at all. This creates a vulnerability in the EU single market that could be exploited by nefarious actors.

While it remains a question whether the FDI regulations should target specific countries of concern (for example, stricter provisions for Chinese investors), it should certainly be avoided to use the FDI screening regimes arbitrarily against fellow democratic countries and allies out of protectionist – "tech sovereignty" or "strategic autonomy" – reasons. Economic protectionism within the free and democratic world should be avoided as much as possible.

At least within this area, open market principles must be upheld. However, those principles must not be turned into strategic vulnerability vis-à-vis authoritarian countries disdaining such principles. The establishment, and proper calibration, of FDI screening mechanisms will contribute to ensuring this.

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