



## Safe and Sound: An EU Approach to Sovereign Investment

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### Memo Questions & Answers

#### **Why this policy brief?**

Bruegel identifies foreign investment into the EU as a rising issue for the public policy debate. The current financial crisis both increases Europe's need for inward investment, and raises the political sensitivity of such investment by magnifying concerns about loss of control over economic players. This was recently illustrated by recent comments from the Italian and French governments about the need to protect 'national' companies from foreign 'predators'.

Looking specifically at the changing patterns of international investment, the policy brief identifies underlying trends which are likely to strengthen political concerns about foreign investment in the mid-term, as a rising share of such investment will probably come from countries with illiberal political regimes, thus raising legitimate security concerns which the EU did not have to tackle in earlier times. If left unaddressed, such concerns could contribute to a harmful trend towards protectionism and the fragmentation of Europe's internal market.

#### **What do the authors mean by sovereign investment? How does it relate to SWFs?**

'Sovereign investment' is a catch-all term used by the authors to refer to foreign investment ultimately controlled by governments. Sovereign wealth funds (SWFs), which have focused public and media attention since early 2007, are a subcategory of sovereign investment, which also includes investments by other state-owned entities and companies, as well as investments by private-sector actors under heavy influence from their home governments. In that sense there is no precise legal definition of sovereign investment, which is a useful notion for the public policy debate nevertheless.

#### **How do the authors classify political regimes?**

The authors use a classification of political regimes by Freedom House, a respected independent NGO founded in 1941. Freedom House's 'Freedom in the World Report', published yearly since 1973, classifies countries into 'free', 'partly free', or 'not free'. For more information on the Freedom House report, please click [here](#).

#### **Will the investment trends identified by the authors be sustained in spite of the current crisis?**

The crisis will certainly have an impact on the worldwide distribution of wealth and on patterns of international investment. However, the recent emergence of large current-account surpluses in countries with illiberal political regimes, which is highlighted in the policy brief, is unlikely to be entirely reversed by the fallout from the crisis – even assuming a sharp further drop in the oil price and/or some unwinding of the current global economic imbalances.

#### **What are the risks from the new trends in inward investment into the EU?**

Most inward investment into the EU is benign and should be welcomed, especially in the current context of financial constraint resulting from the crisis – including when the investment comes from illiberal countries. However, in a limited number of cases it can happen that a foreign acquisition

creates a risk to national or European security. Conversely, concerns about foreign investment create the risk of a protectionist drift inside the EU, with certain member states taking measures that could harm not only themselves but the entire internal market as well.

Finally, it cannot be ruled out that illiberal countries use their wealth to disrupt entire markets or economies, but the EU appears less affected by this risk than other economies. This aspect, though relevant, is not discussed in depth in the policy brief.

### **Why introduce a new framework? Are existing arrangements not sufficient enough?**

The Treaty on the European Community provides guarantees for the internal market and includes exceptions about national security and the defense industry. However, the treaty alone does not ensure a consistent approach to the review of foreign investment in individual member states, and the authors argue that specifying such a framework with secondary legislation – i.e., an internal market directive – would change the dynamics of this entire policy area. It would also allow a much higher level of coordination among member states on this issue, which is all the more important in an internal market where a foreign acquisition in one country could very possibly affect national security in another one.

Current EU trade and competition policies, the authors warn, were designed for economic concerns only and should not be used for security matters.

### **What kinds of safeguards are proposed in the policy brief to avoid a more protectionist Europe?**

The new EU-level legislation advocated by the authors should not itself introduce unnecessary barriers to foreign investment into the EU. To avert that risk, they call for EU leaders to solemnly commit to openness towards foreign investments at the outset of the legislative process, and simultaneously to emphasize the legislation's focus on 'hard' security as opposed to a catch-all (and excessively open-ended) notion of 'economic security'. This should ensure that the legislation is not mistaken for another way to block acquisitions which pose no security risks and make business sense. The authors also recommend that this legislative process be based on a wide public debate.

### **What form of framework does the policy brief envision?**

The authors advocate framework legislation (an EU internal market directive) covering foreign acquisitions (involving a change of control) of European companies. Implementation of the legislation, i.e. the review of individual acquisition cases and corresponding decisions, would remain carried out at national level. EU-level coordination would be allowed by the creation of an EU committee, possibly coordinated by the High Representative for Common Foreign and Security Policy. The European Commission could of course initiate infringement procedures if relevant, and appeals would be possible through the European court system.

### **Will the proposed legislation restrict investment into countries which want to welcome foreign investments?**

No. A policy for the review of foreign investment is (over the long term) a necessary condition for, rather than a barrier to, openness to such investment. Denial of the possible security risks would be a poor way to boost the case for economic openness.

The US has the same type of legislative framework (Exon-Florio amendment of 1988) and has remained one of the world's most attractive economies for foreign investors, to which it is arguably

more open than many continental European economies. The Exon-Florio policy framework has remained remarkably stable in spite of significant geopolitical changes in the past two decades.

**Is member states' sovereignty over their national security threatened by this policy proposal?**

The proposed legislative framework provides a common anchor for member states' review of foreign investment, including a common concept of national security, common procedures, and a degree of cross-border coordination during the process. But it leaves the final decision on whether to authorise, block, or seek changes in each individual foreign acquisition in the hands of the member state concerned, thus fully respecting its sovereignty over national security.