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SPECIAL ISSUE ARTICLE

Naïve no more: Foreign direct investment screening in the European Union

Sarah Bauerle Danzman[1] | **Sophie Meunier**[2]

[1]Indiana University, Bloomington, Indiana, USA

[2]Princeton University, Princeton, New Jersey, USA

Correspondence
Sarah Bauerle Danzman, Indiana University, 355 N Eagleson Rd., Bloomington, Indiana 47405,USA.
Email: sbauerle@indiana.edu

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Abstract

This paper asks what explains the creation and comparative features of national Investment Screening Mechanisms (ISMs) in Europe. After providing a brief history and definition of ISMs, we provide descriptive patterns about the similarities and differences in the investment screening features of national ISMs in EU member states. We then explain differences in national screening policies by focusing on the role of public debt, Chinese investment, R&D expenditures and various geographic groupings. Finally, we make three policy arguments about the rise of ISMs in Europe: (1) ISMs have not been designed as protectionist instruments, (2) the politics of inward investment screening reflects a shift from economic to security logic in addressing the fundamental tension between the benefits and vulnerabilities of open markets and (3) the EU can use the 'commercialisation' of security to extend its own competence in the security sphere. We conclude by considering how the rapid expansion of investment screening in Europe could affect economic openness, as well as the role of the EU as a global actor.

1 | INTRODUCTION

Since its founding, the European Union (EU) has pursued a trade policy agenda based on openness, multilateralism and use of commercial instruments to further social standards and good governance objectives. In recent years, however, EU officials and member states came to see their commitment to these liberal guiding principles as a burden in face of an increasingly unlevel playing field, characterised by China's continued use of market-distorting industrial policy and failure to reciprocate economic openness, increasingly protectionist and unilateral policies from the United States and the ever-growing threat of Russia through energy dependence. By 2017, the EU declared the end of its 'naivete' and undertook a major strategic shift towards a more assertive trade policy through a series of new unilateral instruments (Juncker, 2017).

The first such instrument in the EU's new defensive arsenal is the creation of a Foreign Direct Investment (FDI) screening framework at the EU level, which has happened in parallel with the reinforcement or creation of national Investment Screening Mechanisms (ISM) in the EU member states. From only eight countries with some screening of investment at the cusp of the financial crisis in 2008, today 26 member states have an investment screening regime already in effect or being drafted. Why have European countries finally joined the bandwagon of advanced industrialised economies with routinised legal processes for screening inward investment? Why does significant variation in design features exist between the various European ISMs? And what does the advent of widespread investment screening in Europe mean for the future of economic openness, for the links between economy and security, and for the role of the EU as a global actor?

This paper explores the evolving content of EU members' ISMs, an exercise that illuminates how member states' beliefs about national security implications of economic exchange have evolved in recent years. Using the newly coded Politics and Regulation of Investment Screening Mechanisms (PRISM) data set,

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we examine correlates of broad trends in European ISMs and variation in institutional design. We argue that the main determinants of a country's investment screening regime are its R&D expenditures and its geographic proximity to Russia, more so than its public debt position or the role of Chinese investment in the national economy.

The paper proceeds as follows. Section 1 provides a brief history and definition of investment screening mechanisms. Section 2 presents the new EU investment screening framework, which establishes an institutionalised instrument for cooperation between the EU and the member states in reviewing FDI transactions that are potentially problematic for national security and public order in Europe. Section 3 provides descriptive patterns about the similarities and differences in the investment screening features of national ISMs in EU member states. In Section 4, we explain differences in national screening policies by focusing on the role of public debt, Chinese investment, R&D expenditures and various geographic groupings. Based on these observations, Section 5 makes three key policy points about some of the implications of the rise of ISMs in Europe: (1) ISMs have not been designed as protectionist instruments, (2) the politics of inward investment screening reflects a shift from economic to security logic in addressing the fundamental tension between the benefits and vulnerabilities of open markets and (3) the EU can use the ‘commercialisation’ of security to extend its own competence in the security sphere. We conclude by considering how the rapid expansion of investment screening in Europe could affect economic openness, as well as the role of the EU as a global actor.

2 | WHAT IS INVESTMENT SCREENING

FDI has often been welcomed because of its many economic benefits for the host country: it provides jobs and spillovers in know-how and technological innovation, which in turn can foster local economic growth (Pandya, 2016). Since the 1970s, most countries have loosened their regulations towards inward investment and competed against each other through a variety of incentives to attract FDI (Bauerle Danzman, 2019; Pandya, 2014).

Despite these economic benefits, however, certain foreign investments potentially carry risks, notably for national security. For instance a transaction could enable a foreign investor to acquire cutting-edge technology, transfer it to their home country and then liquidate the firm where the technology originated; an investment in critical infrastructure could enable a foreign investor to block transportation routes or cripple energy supplies in the event of conflict between home and host country; a foreign investor in an e-commerce site or dating app could acquire sensitive personal data that could then be transmitted to their home government for use as leverage against specific individuals.

To mitigate these real or perceived risks, an increasing number of countries have, over time, developed procedures to screen foreign investment. Investment screening is the practice by which governments review inward FDI transactions and deny entry to, or require the divestment of, investments that are deemed unacceptable, usually on grounds of national security. Investment screening mechanisms (ISMs) are routinised legal processes of investment screening based on predetermined criteria. That is, ISMs are the codified rules that governments follow when screening investments.

Investment screening is not new. For most of the 20th century, many governments screened inward FDI. Usually, these review mechanisms evaluated whether an investment project would add positively to domestic economic growth. For example, Sweden made all foreign acquisitions subject to government review in 1973 and required foreign investors to source at least 50 percent of capital overseas. France had similar investment screening provisions that were only relaxed for non-EU-originating FDI in 1992. Most countries removed these screening mechanisms through the 1980s and 1990s as governments liberalised their foreign investment regulations. In the EU context, economic benefit-oriented investment screening was seen as incompatible with the internal market.

What is novel about contemporary ISMs is their security, not economic, dimension (Bauerle Danzman & Meunier, 2023). The new regimes that have been recently created or tightened are aimed at reviewing the essential security interests that inward investment may negatively affect. Such screening may be compatible with – and even necessary to sustain – a largely permissive investment environment. Indeed, these security-based screening mechanisms co-exist with efforts to attract more investment through promotion and incentives, as well as through a welcoming environment for Sovereign Wealth Funds (Thatcher & Vlandas, 2021). The United States' investment screening mechanism, for example, was designed to blunt calls for more protectionism (Baltz, 2017; Kang, 1997).

Many countries have adopted investment screening rules over time (Bauerle Danzman & Meunier, 2023). The United States created arguably the gold standard ISM through its Committee on Foreign Investment in the United States (CFIUS) and successive legislations since the 1970s, which have implemented a comprehensive cross-sectoral review of inward investment. Australia has screened FDI since 1975. Canada began screening in 1985, though only added a national security test in 2009. In Europe, Germany

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has screened FDI since 2004 and France since 2006. Many other European countries have promulgated some form of investment screening in recent years, as discussed below. Despite the recent proliferation of ISMs, however, there remains substantial variation in how they are structured, including what kinds of investments are reviewed; whether review is mandatory and investment requires preauthorisation to proceed; the criteria through which transactions are evaluated, approved and prohibited and who within the government reviews investments. These design variations reflect important differences among countries with respect to how governments interpret essential security threats, different legal traditions and what governments and civil society view to be the appropriate balance between open markets and state intervention.

3 | THE EU INVESTMENT SCREENING FRAMEWORK

The adoption or tightening of security-based investment screening mechanisms in Europe has accelerated in the wake of the European Union's creation in March 2019 of the first pan-European investment screening framework, which began operation in October 2020.[1] This framework provides an instrument for cooperation between the EU and the member states in reviewing FDI transactions that are potentially problematic for national security and public order in Europe. Though relatively modest in its ambitions, it has already been consequential in prompting the creation of national ISMs in many EU member states that were not previously screening FDI.

The process that led to the adoption of the EU screening framework began in 2017 when the European Commission started elaborating a proposal for investment screening at the EU level (Vlasiuk Nibe et al., 2022). This was made possible by several events. First, after an almost decade-long controversy, the Court of Justice of the European Union confirmed that the EU was indeed competent over foreign direct investment policy (Meunier, 2017). Second, in February 2017 the governments of France, Germany and Italy asked the Commission to draft legislation on investment screening at the European level after a series of Chinese investments in their country had created political and security challenges (Chan & Meunier, 2022). And third, by 2017 the Commission had become less 'naive' towards its trade partners, leading the traditionally free-trade DG Trade to develop instruments to ensure the EU's strategic autonomy. As a result, the EU screening framework was adopted very quickly in March 2019, less than 18 months after the start of the policy-making process.

The EU framework differs from national ISMs because it only provides a supplementary level of review and a mechanism for national cooperation. It does not replace investment screening conducted at the national level. This is due to the EU's complex layering of competences, where supranational policy-making authority in the trade and investment coexists with remaining national sovereignty in some areas of economic policy and in security and defence policies. As a result, the EU mechanism is not a binding supranational mechanism and thus not an European CFIUS.

Instead, the EU ISM is characterised by two central features. First, the Regulation lays out procedures followed by the Commission to be notified of, and to investigate, transactions with the potential to affect security and public order. The Commission can only provide an advisory opinion after investigating a transaction and the authority to block a transaction remains with the relevant Member States. This reflects the fact that national security issues remain a national competence. Second, the EU framework forces cooperation and sharing of information between the different member states and between the national and supranational levels, mostly for investments in critical technologies and infrastructure.

According to the reports on the application of the new EU screening framework published by the European Commission in 2021 and 2022 (European Commission, 2021, 2022), the EU has investigated a small number of transactions overall: in 2021 the EU received 414 notifications of potentially problematic transactions; while most cases were closed after a rapid 'Phase 1' screening, 11% were scrutinised by the Commission in its more rigorous 'Phase 2' process, especially in the sectors of Manufacturing, Information and Communications Technology and Financial Activities. Less than 3% of the cases notified led to the Commission eventually issuing an opinion The home country of the investor in the transactions reviewed by the EU were primarily the US, the UK, China, the Cayman Islands and Canada.

4 | INVESTMENT SCREENING IN THE EU: DESCRIPTIVE PATTERNS

The number of EU member states with investment screening procedures expanded greatly over the past decade. In 2007, on the cusp of the global financial crisis, only eight EU countries had some kind of investment review regime: Denmark, Finland, France, Germany, the Netherlands, Poland, Spain and the United Kingdom.[2] The majority of these mechanisms were limited to narrow applications.[3] For instance, Denmark's investment review was confined to defence production, while the Netherlands' screening regime focused on energy infrastructure. Poland limited

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screening to real estate and airport transactions. Of the five largest economies in the EU, only Italy did not have a screening mechanism in 2007. However, the U.K.'s screening authority was circumscribed; it rested on a 2002 merger control law that allowed the government to consider national security concerns in its review of acquisitions.

By contrast, in 2021, eighteen EU countries had at least one ISM. The countries that developed new ISMs after 2007 include: Austria, Czech Republic, Estonia, Hungary, Italy, Latvia, Lithuania, Malta, Portugal, the Slovak Republic and Slovenia.[4] Moreover, as of December 2022, of the remaining member states without active ISMs, only Bulgaria does not have investment review draft legislation in progress. Despite this large increase in ISM adoption, there remains important variation in mechanism design among the member states.

Table 1 provides an overview of the features of EU member states' ISMs (Bauerle Danzman and Meunier, 2023). Several descriptive features stand out. First, national approaches to investment screening are converging in several respects. First, almost all EU member states now have ISMs. Even members who were ideologically opposed to investment screening in 2017 (such as Denmark, Ireland and Sweden) have already adopted, or are in the process of developing, investment screening legislation. As for member states with longer histories of investment screening, they have, with important exceptions, strengthened their screening authorities in recent years.

Figure 1 illustrates a second point of convergence: the number of sectors reviewed by ISMs has greatly increased over time. These sectors of interest are also converging, as member states with ISMs universally review transactions in critical infrastructure and defence. A sizable proportion of member states also review critical technology sectors – often defined as technologies subject to dual-use export controls and many countries review acquisitions of media companies.

Finally, a third point of convergence regards the decrease in equity thresholds necessary to trigger review. Between 10 and 20 percent acquisitions are rapidly becoming the standard, whereas 25–50 percent was more common in previous decades.

Nevertheless, despite a directional movement towards more and stricter screening, there remain important differences among national mechanisms. While the EU FDI screening regulation requires Member States that choose to have ISMs to comply with a minimum set of standards,[5] there is no EU ISM template and EU member states have not converged on a harmonised approach to screening across several major design features.

First, there is variation over the scope of review. Twelve EU members have sectoral review mechanisms.[6] Countries with sectoral screening only grant government authority to review transactions in prescribed industrial sectors. Four members have cross-sectoral screens, meaning government authorities can review any transaction regardless of the business activity of the acquisition target. Germany has a mixed system in which it applies a broad sectoral voluntary review process alongside a stricter, mandatory review process for a subset of particularly sensitive sectors. Moreover, there is no evidence that newer ISMs are converging on a particular approach to scoping; new mechanisms are just as likely to be sectoral in nature as they are cross-sectoral.

Second, EU members vary in terms of their screening thresholds and basic procedures. While transactions over 10 percent are reviewed in most EU member states, there are important exceptions. Some countries adopt a procedure in which transactions in the most sensitive sectors are screened at a lower acquisition threshold while transactions in other sectors are only reviewed if a foreign entity takes a larger equity stake. Portugal, a clear outlier, still only screens majority-owned transactions. Similarly, most EU members have mandatory notification and approval, but some limit the review requirement to a subset of the most critical sectors. There also remains substantial variation regarding whether governments can review increases in foreign ownership within the same target, in which government agency investment review is housed and whether there exists interagency review of transactions and whether investment coming from other EU member states is also subject to screening.

Countries vary rather substantially in who in government oversees review and in the risks concepts that allow for blocking a transaction (table available in Appendix S1). For instance, while Portugal and Slovenia require ‘actual and sufficiently serious threats’ to public order and security to prohibit a transaction, other countries allow for blocks based on the ‘likelihood’ of an effect or the ‘potential’ endangerment of national security. These seemingly minor differences in language affect the standards of evidence that are required to justify the prohibition of a transaction. In terms of review bodies, most EU member states designate the economy ministry or its equivalent with the authority to review. However, some require cross-ministry evaluation. Variations in who has review authority can also have important implications for how ISMs weigh risks of investment, balance these risks against economic growth rationales, and the extent to which review may be either politicised by hawkish elected officials or captured by business elites. As ISMs mature and generate more years of data on transaction reviews, mitigation measures and investment prohibitions, researchers should examine how these variations in design affect patterns of investment flows.

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TABLE 1 Overview of ISM characteristics.

Country	Year of adoption	Most recent change	Scope	Threshold	Minimum size	Mandatory authorisation	Green-field	Review length	Sectors
Austria	2011	2020	Sectoral	10–25%	yes	yes	no	1–3 months	22
Belgium	2022	2022	Sectoral	10%	yes	yes	no	60 days	22
Bulgaria	n.a.								
Croatia	drafting								
Cyprus	drafting								
Czech Republic	2021		Cross-sectoral	10%	no	Some Sectors	no	165 days	n.a.
Denmark	1990	2021	Cross-sectoral	10–25%	no	Some Sectors	yes	90 days	n.a.
Estonia	2012	Drafting	Land	10 Hectares	yes	yes	n.a.	75 days	1
Finland	1993	2020	Cross-sectoral+	10%	yes	Defence & Dual Use	no	90 days	n.a.
France	1966	2020	Sectoral	10%	no	yes	no	75 days	21
Germany	2004	2021	Mixed	10/20/25%	no	Some Sectors	no	120 days	n.a.
Greece	n.a.								
Hungary	2019	2020	Sectoral	10–20%	no	yes	no	60 days	14
Ireland	drafting								
Italy	2012	2022	Sectoral	3%	no	yes	no	65 days	23
Latvia	2017	2020	Sectoral	10%	no	yes	no	120 days	6
Lithuania	2018	n.a.	Sectoral	25–30%	no	Some Sectors	no	25 days	13
Luxembourg	drafting								
Malta	2020	n.a.	Sectoral	10%	no	yes	yes	70 days	24
Netherlands	1998	2022	4 Sectoral Mechanisms	'control'	no	yes	no	270 days	8
Poland	1920	2020	Mixed	20%	yes	Some Sectors	no	150 days	10
Portugal	2014	n.a.	Cross-sectoral	50%	no	no	no	60 days	n.a.
Romania	drafting								
Slovak Republic	2021	2022	Cross-sectoral	10%	no	yes	no	60 days	n.a.
Slovenia	2020	n.a.	Sectoral	10%	no	yes	yes	60 days	19
Spain	1975	2020	Mostly sectoral	10%	yes	Some Sectors	no	180 days	21
Sweden	drafting								

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TABLE 1 (Continued)

Country	EU covered?	Interagency review	Review increased ownership	Penalties	Critical tech	Media
Austria	no	Consulting	yes	Criminal	Second tier	Second tier
Belgium	no	yes	no	Fines (10–30%)	First tier	Second tier
Bulgaria						
Croatia						
Cyprus						
Czech Republic	no	yes	no	Fines (1–2% revenue)	First tier	First tier
Denmark	First tier sectors	no	yes	Revoke voting rights	First tier	Second tier
Estonia	yes	no	unclear	unclear	not covered	not covered
Finland	Defence	no		divestment	First tier	Second tier
France	yes	yes	no	Fines (10% turnover); criminal	yes	yes
Germany	Mandatory sectors	for blocks	yes	Criminal & fines	Second tier	First tier
Greece						
Hungary	yes	no	COVID temporary (ended 6/2021)	Fines	yes	yes
Ireland						
Italy	Defence & national security sectors	yes	yes	Fine; suspension of voting rights	yes	yes
Latvia	yes	yes	yes	invalidation of transaction	not covered	yes
Lithuania	yes	yes	yes	none known	yes	yes
Luxembourg						
Malta	yes	no	unclear	Fines	yes	yes
Netherlands	yes	no	for sensitive technology	Fines; invalidation of transaction	yes	not covered
Poland	no	no	yes	fines; criminal penalties	not covered	not covered
Portugal	no	yes	no	invalidation of transaction		
Romania						
Slovak Republic	yes	no	yes	Fines up to EUR 50,000	yes	yes
Slovenia	yes	no	no	fines, but no standstill	yes	yes
Spain	Partially	yes	no	Fines; invalidation of transaction	yes	yes
Sweden						

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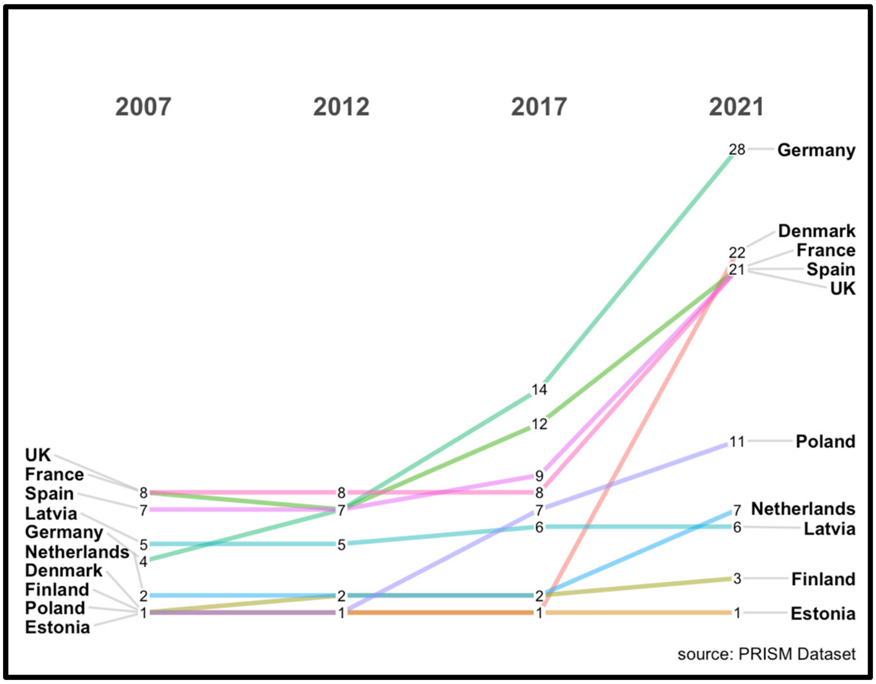

FIGURE 1 Number of sectors screened, EU countries with sectoral ISMs.

5 | EXPLAINING DIFFERENCES IN NATIONAL POLICIES TOWARDS INVESTMENT SCREENING IN EUROPE

Although most EU member states now have ISMs or are actively drafting them, they have varied in terms of the speed with which they implemented these mechanisms and how restrictive these regulations are in practice. While researchers will need several more years of data before quantitative analysis on the comparative effect of ISMs will be possible, in this section we use the PRISM data set to run simple association tests regarding several common expectations about what might lead to ISM implementation.

First, we might expect countries facing higher budget deficits – particularly in the context of the Eurozone crisis – to be less picky about the source of external investment and, therefore, less likely to implement investment screening measures (Meunier, 2014). We measure fiscal position by central government *Net Lending* over GDP (Eurostat, 2022).

Next, we consider how the presence of Chinese investment may be associated with the propensity to enact an ISM (Chan & Meunier, 2022; Ufimtseva, 2020). Such investments could act in countervailing ways, either by raising awareness regarding potential national security risks or by generating a pro-China lobby. We measure *Chinese FDI* as the cumulative value of transactions (USD m) identified in AEI's China investment tracker.[7]

Countries that are major investors abroad may be concerned about reciprocity when developing inward FDI policy and might, therefore, be more hesitant to enact screening legislation (Chilton et al., 2020). We measure this through *Outbound FDI*, indexed by GDP (Eurostat, 2022).

Finally, we consider whether countries with higher levels of Research and Development (*R&D*) are more likely to screen inward FDI to protect the intellectual property that emerges from R&D investments (Chan & Meunier, 2022). We use Eurostat's measure of gross expenditures (both public and private) on R&D, divided by GDP (Eurostat, 2022).

We run simple logistic regressions with the country year as the unit of analysis and an indicator variable for whether the country had an active ISM that year as the outcome variable (Table 2). We report standard errors clustered by country. In the Appendix S1, we include robustness checks that include a lagged dependent variable, year fixed effects and an indicator variable equal to one for each year that the EU ISM regulation was in place (i.e. 2019 onwards) (A2-3). Unless otherwise indicated, our results are robust to the inclusion of these controls. We find that, rather than being driven by fiscal position or the role of Chinese investment in the economy, R&D expenditures are most strongly associated with having an ISM. In contrast, inward Chinese investment is statistically significantly associated with ISMs, but the relationship is substantively small. As anticipated, countries with high levels of outwards FDI are less likely to have an ISM, but this is not statistically significant.

Given the richness of the PRISM data set, we can also examine the correlates of specific characteristics of ISMs. Table 3 reports negative binomial regression results of models in which the outcome variables are the running number of ISM law changes since 2007 in a country year and the number of technology sectors subject to screening.[8] Since only Chinese FDI and R&D expenditures are statistically significantly associated with the presence of an ISM, we focus on these two explanatory variables. Again, we cluster standard errors by country. Models with year fixed effects are reported in the Appendix S1 and do not change our results (A4-5). We see that both Chinese FDI and R&D spending continue to be statistically significantly associated with an increase in the number of ISM law changes and the number of technology sectors covered.

Finally, we consider whether four different geographic and club groupings are associated with the propensity to enact an ISM. Table 4 reports results. First, we anticipate that bordering Russia increases the likelihood that a government will have an ISM. There is a long history of concern regarding Russian influence in bordering economies, often related to energy and other critical infrastructure. We measure *Borders Russia* as an indicator variable equal to one if the country shares a border with Russia. We do find that countries that border Russia are much more likely to have developed an ISM earlier than other member states. The importance of national security threats from Russia in the development of ISMs in Europe is an important corrective to common beliefs that investment screening is entirely a reaction to China.[9] A potential alternative explanation is that post-Soviet states are just more likely to have regulations on investment. However, Model 10 shows that post-Soviet states as a group are less likely to develop ISMs early in the period studied, though this result is not statistically significant ($p = 0.16$).

We also find that membership in the People's Republic of China's (PRC) Belt and Road Initiative (BRI) is not associated with an increased or decreased propensity to have an ISM. This is likely because many BRI participants border Russia and the development of ISMs in Europe have been driven by a confluence of multiple nation security concerns rather than being driven entirely by risks associated with China's economic rise. Finally, Model 12 indicates that countries that belong to the PRC's 16 + 1 initiative (now 14 + 1), which is a cooperative agreement between the PRC and many Eastern European countries are no less likely to have enacted an ISM than other EU countries. This may reflect the fact that many 16 + 1 countries also border Russia, and so their ISMs may be more focused on national security threats emanating from non-Chinese investment.

TABLE 2 R&D expenditures associated with ISMs, other measures largely insignificant.

	Model 1	Model 2	Model 3	Model 4
Constant	−0.37	−0.77*	−0.304	−1.83*
	(0.370)	(0.36)	(0.341)	(0.716)
Net Lending/GDP	−0.00			
	(0.052)			
Chinese FDI		0.00*		
		(0.00)		
Outwards FDI/GDP			−0.01	
			(0.006)	
R&D/GDP				103.220*
				(49.566)
N	405	420	392	391
Log Likelihood	−274.1	−254.9	−262.7	−237.2
BIC	560.2	522	537.3	486.4

Note: + $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$; (standard errors).

6 | INVESTMENT SCREENING AND THE BLURRING OF ECONOMIC AND NATIONAL SECURITY

Despite a significant increase in the passage of screening laws in recent years, European countries' screening regimes remain highly varied, as underscored by the above empirical patterns of ISM design and implementation. Countries with large R&D expenditures are more likely to have ISMs and more likely to have cross-sectoral review authority. At the same time, countries

TABLE 3 Chinese FDI and R&D spending associated with more ISM lawmaking and scrutiny of the technology sector.

	Model 5: Law change	Model 6: N tech sectors	Model 7: Law change	Model 8: N tech sectors
Constant	−0.90***	0.57***	−1.87***	−1.59***
	(0.103)	(0.108)	(0.228)	(0.233)
Chinese FDI	0.00***	0.00***		
	(0.000)	(0.000)		
R&D/GDP			77.92***	83.05***
			(12.514)	(13.350)
N	420	420	391	391
AIC	846.7	994.4	732.5	856.7

Note: + $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$; (standard error).

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TABLE 4 Countries that border Russia are more likely to have developed an ISM Early.

	Model 9	Model 10	Model 11	Model 12
Constant	−0.58	0.05	−0.31	−0.20
	(0.378)	(0.426)	(0.362)	(0.368)
Border Russia	1.66*			
	(0.669)			
Former Soviet		−0.92		
		(0.658)		
BRI			0.10	
			(0.450)	
Sixteen +1				−0.35
				(0.592)
N	420	420	420	420
Log Likelihood	−267.8	−277.0	−286.7	−285.6
BIC	547.6	566.1	585.6	583.3

Note: + $p<0.1$, * $p<0.05$, ** $p<0.01$, *** $p<0.001$; (standard errors).

that border Russia are more likely to have ISMs. Often these mechanisms are more focused on critical infrastructure and energy. And there is less evidence that patterns of Chinese FDI explain variations in ISM implementation. In other words, the road to an ISM is winding and based on multiple sources of national security threats.

In this section, we make three key policy points about some of the implications of the rise of ISMs in Europe: (1) ISMs have not been designed as protectionist instruments, (2) the politics of inward investment screening reflects a shift from economic to security logic in addressing the fundamental tension between the benefits and vulnerabilities of open markets and (3) the EU can use the increased blurriness between economic and national security issues to expand the 'commercialisation' of security competence.

6.1 | ISMs are not designed as protectionist instruments

The recent spread of investment screening, not only in Europe but globally, is often interpreted as evidence of the rise of protectionism. Even in the absence of an economic benefit test, many worry that governments could use national security arguments to justify protectionist measures, especially since the definitions of essential security are vague by design (Lai, 2021). Some have questioned, for instance, whether rumours that the French government had asked the Canadian company Couche-Tard not to takeover French retail giant Carrefour in 2021 had much to do with national security (Le Monde, 2021). The expansion of ISMs thus creates a risk to the maintenance of a broadly liberal investment environment.

We argue, however, that ISMs have not been designed as protectionist instruments, even if they could be captured as such by politicians. On the contrary, given the potential for 'coercive' capital to undermine democratic institutions, European integration and economic liberalism through corruption, economic coercion and trade-distorting state aid, narrowly scoped investment screening may be necessary to prevent full-throated economic protectionism. Just as the liberal project in post-World War II Europe required social welfare embeddedness (Ruggie, 1982), maintaining open markets in the shadow of adversarial military powers with state-connected global business entities may require embeddedness in a security framework. This is precisely how the European Commissioner Thierry Breton framed investment screening in his September 2020 call to the end of 'naivety': 'A powerful and geopolitical Europe that protects our critical companies against predatory – sometimes politically motivated – foreign acquisitions' (Breton, 2020).

Moreover, new ISM legislation has largely occurred due to government officials' desires to find ways to depoliticise investment review by standardising and routinising screening processes (Waever, 1995). In many cases, the impetus for developing new ISMs or legislatively strengthening existing ones has occurred in the aftermath of specific transactions that generated substantial political pushback on security grounds, but for which existing legal authorities did not provide a means to prohibit (Canes-Wrone et al., 2020). This is true outside of the EU as well. For instance, the 2007 legislative update to CFIUS was predicated by Dubai World Ports' proposed acquisition of several U.S. port authorities. In the French context, PepsiCo's 2005 rumoured proposed takeover of Danone and Lucent's 2006 merger with Alcatel motivated politicians and the French public to support a major overhaul of its screening authorities so that legislative tools would exist instead of decisions made on an ad hoc basis. More recently, foreign acquisitions involving Alstom, Technip, Peugeot-Citroen and Accor were effectively framed through security lenses to justify increased scrutiny of foreign investment (Rosemain et al., 2018). Germany established an ISM in 2004, but significantly strengthened it after the infamous KUKA transaction in which a Chinese firm bought the German robotics company in 2016 as well CFIUS's decision to block a Chinese SEO's acquisition of German semiconductor company Aixtron a few months later. Discussions regarding developing a full-fledged ISM accelerated in the UK in the aftermath of the Hinkley Point C transaction in which China General Nuclear Power Group, a SOE, financed a nuclear power station. In 2021, the UK removed the Chinese entity from a different nuclear power station project (Reuters, 2021).

As current and former EU members have confronted high-profile transactions – almost always with Chinese

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buyers, though France has baulked at US investors too – policymakers have sought to channel a broad interest in preventing transactions with clear national security concerns in a manner that depoliticises the review process in order to decrease uncertainty among the business community and to ensure that transaction blocks are rare and fact-based. In other words, ISMs represent policymakers' desire to turn down the heat of specific transactions that might generate popular outrage. By channelling review through a bureaucratic process, rather than through ad hoc, public processes, governments can make it harder for politicians to use opposition to high-profile foreign acquisitions as a political cudgel. Indeed, Vlasiuk-Nibe, Meunier and Roederer-Rynning have labelled the strategy used by the European Commission in trying to get approval from initially reluctant member states for its new EU-wide investment screening framework as 'pre-emptive depoliticisation' (2022).

So far, the expansion of investment screening in Europe has not turned into protectionist obstacles against investment. The EU's second annual investment screening report reveals that, of the 1563 transactions notified to EU member states' ISMs in 2021, only 29 percent were formally screened (about 453) and 73 percent of those (about 330) were unconditionally approved (European Commission, 2022). Member States cleared 23 percent (about 104) with mitigation requirements. Only one percent of transactions were prohibited outright. These figures are an indication that EU ISMs are used to block transactions rarely and are, therefore, not, at least for now, used as a protectionist instrument.

Furthermore, the EU has acted as a backstop against situations in which member states have seemed to use their country-level ISM for more protectionist reasons. For example, the European Commission determined in February 2022 that Hungary's April 2021 prohibition of Austrian insurance group VIG's acquisition of Dutch AEGON's Hungarian subsidiary violated EU Law (Hogan Lovells, 2022). In this particular case, the Hungarian government had already negotiated a sweetheart deal for a state-owned investment fund to participate in the acquisition. However, the Commission ruling may provide firms with a better negotiating position if a Member State tries to use its ISM for protectionist purposes in the future.

One area to watch, however, is how Member States will treat intra-EU investments moving forward. The AEGON/VIG case above concerns intra-EU transactions. ISMs that review such transactions undermine the single market for investment. While some new ISMs explicitly exclude intra-EU investments from review, several countries extended investment review to such transactions during the Covid pandemic or created a brand new ISM with intra-EU screening, such as Denmark. While regulators justified these actions as necessary, and temporary, restrictions to prevent 'fire sale' FDI, several governments, such as Italy, have continued to extend these 'temporary' powers (Cleary Gottlieb, 2022). If EU ISMs continue to subject investment from within the European Economic Area, this will be a major asterisk on the concept of the single market.

6.2 | ISMs represent a shift from market to security logic

The rise of inward investment screening illustrates key conundrums regarding the benefits and vulnerabilities of open markets. From an economic perspective, investment screening adds additional regulatory burdens to firms that benefit from the ability to merge with, acquire and be acquired by other global firms with little governmental interference. For instance, owners of small- and medium-size businesses in Germany have benefited greatly from Chinese acquisitions (Harper, 2021). Within the EU, many member states were indifferent to, or strongly opposed to, an EU-wide investment screening policy when it was first considered in 2017 (Chan & Meunier, 2022). The reasons behind their opposition ranged from concerns regarding how a screening mechanism might negatively affect foreign investment-led growth models to public sector dependence on Chinese investment in the wake of the Euro crisis, to strong commitments to neoliberal market orthodoxy (Babić & Dixon, 2022; Chan & Meunier, 2022). These concerns largely spanned the political spectrum.

From a security perspective, however, a liberal inward investment environment comes with potential vulnerabilities. Foreign ownership of critical infrastructure could render energy, information, water and transportation networks vulnerable to disruptions by malicious actors. Foreign ownership of advanced technologies could transfer intellectual property and know-how to foreign militaries who could use these advanced technologies to upgrade their offensive capabilities. Economic competitors could acquire advanced technology firms, thus eroding the host country's market share and leapfrogging technical frontiers. Personal data acquired through investment could be misused by economic competitors or political opponents for a variety of nefarious purposes.

The strengthening of ISMs across member states represents a shift from market logic to security logic in dominating investment policy discussions (Cohen, 2020; Roberts et al., 2019). The reason for this shift is multi-faceted. First, the growing importance of state-owned and state-influenced enterprises as a source of inward FDI in recent years has challenged neoliberal concepts regarding clean distinctions between states and markets (Babić, 2023; Babić & Dixon, 2022). Babić estimates that Europe hosts close to half of all cross-border state-owned investments, totalling USD 831 billion (2021, p 214). Close to 60 percent

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of state-owned foreign investment is controlled through state-owned corporations rather than sovereign wealth funds (Babić et al., 2020, 446). State ownership in cross-border acquisitions spiked in the decade after the global financial crisis, rising from an average share of deal ownership of 4.9 percent from 2000–2008 to 10.7 percent in 2009–2018 (Babić et al., 2022, 5).

Second, the geopoliticisation of trade and investment has provided specific and vivid examples of how foreign adversaries' access to and ownership and control of critical infrastructure, information technology networks and even media outlets can be used coercively (Bauerle Danzman, 2021; Farrell & Newman, 2019; Meunier & Nicolaidis, 2019). Russia used its choking power over energy markets to blunt Europe's ability to respond to its 2014 invasion of Ukraine and has also exerted influence over media outlets across Europe to disseminate propaganda and influence elections (Karlsen, 2019). The PRC's assertive diplomacy around Huawei's access to telecommunications networks, its expansion of investments through the BRI and 16+1 initiative similarly generated concern that PRC-connected investments could be used for political economic coercion, notably to temper EU denunciations of the state of human rights in China (Harrell et al., 2018; Zenglein, 2020).

Third, US diplomatic pressure to implement and technical assistance to support investment screening created further pressure to develop ISMs.[10] And, Covid-19 exposed supply chain fragilities that made it easier for countries to secure popular support to quickly pass ISM legislation and made it more challenging for business groups to launch effective counter-lobby campaigns (Gertz, 2021).

6.3 | The 'commercialisation' of security competence in the EU

Investment screening is the first formal tool in a new arsenal of EU policy instruments at the nexus between economy and national security, including the anti-foreign subsidies mechanism to counter the distortive effects of FDI involving state aid and subsidies from non-EU countries (adopted in 2022) and the anti-coercion regulation (adopted in 2023) (Meunier, 2022). Because of the centrality of national security to investment screening, European ISMs, both at the national and EU levels, are also prime examples of the geopoliticisation of European trade and investment policy -geopoliticisation being defined as the 'reframing of a policy issue as a geopolitical problem' (Meunier & Mickus, 2020, p 1081).

Economic relations with China, in particular, have become geopoliticised in Europe (Schild, 2022). The March 2019 communication from the Commission laying out a new China strategy, a parting gift to the new Von der Leyen 'geopolitical commission', labelled China as a 'systemic rival' of the EU (European Commission, 2019). One of the action points included in this strategy was 'the swift, full and effective implementation of the Regulation on screening of foreign direct investment' in order to 'detect and raise awareness of security risks posed by foreign investment in critical assets, technologies and infrastructure.'

By contributing to the increased blurriness between economic and national security issues, the geopolitical framing of investment transactions also has the potential to alter the distribution of competences within the European Union. We call this the 'commercialisation' of security. While the EU has the competence over most trade and investment issues (since the 2009 Lisbon Treaty), the competence over security-related decisions resides mostly with the member states. By folding security issues under the commercial policy umbrella, the EU becomes the relevant authority in charge of making policy. As former EU trade commissioner Cecilia Malmstrom explained, 'At present, decisions are taken by consensus among 27 member states, which makes it hard to reach strong joint positions on strategic matters, sanctions and human right violations. This handicap also makes it difficult to agree on a common strategy towards China. But decisions on trade are taken by qualified majority of EU members, and the negotiations are led by the Commission, giving it a strong voice in that area' (Malmstrom, 2022). In 'commercialising' the various policies linking investment and security, including threats to critical infrastructure and political coercion, the EU can achieve at least two objectives. First, institutionally, the EU (through the Commission) gets more power on an issue over which it currently has little control. And second, substantively, the centralisation of decision-making over security-related investment issues makes it more difficult for one or a few member states to oppose particular policies -thereby making it also more difficult for third countries (for instance China or Russia) to influence the common EU position.

7 | CONCLUSION

This paper explored how and why the screening of inward foreign investment has greatly expanded in Europe in recent years, with many European countries finally catching up with investment screening procedures that had been in place for decades in other advanced industrialised democracies, such as Australia, Canada and the United States. Our main contribution in this paper is a mapping of the evolving features of EU members' ISMs and a description of their institutional design similarities and differences based on the newly coded PRISM data set. We thereby contribute important empirical evidence to the nascent literature on investment screening, as well as to the booming literature on geo-economics and geopoliticisation.

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Our preliminary analysis of correlates of institutional features of European ISMs revealed some interesting, and somewhat unexpected, findings. It is obvious that the EU decision to create pan-European investment screening, as well as the recent tightening of investment screening regimes worldwide, was prompted directly by the rise of China as an outwards investor (Chan & Meunier, 2022; Meunier, 2014, 2019; Schild, 2022). However, we showed that a country's R&D expenditure, more so than its public debt position or the role of Chinese investment in the national economy, determines the existence and features of an ISM in EU member states. This finding that concerns about technology, rather than indebtedness, explains the urge to screen inward investment helps unpack what feels so challenging about Chinese FDI.

Our second important finding is that while everyone has focused on the fear of China as motivation for setting up investment screening procedures, fear of Russia has been a crucial motivation as well. Indeed, we find that geographic proximity to Russia, and therefore, national security threat from Russia, is a strong predictor of a country having developed some form of ISM earlier than other member states. It would be interesting to follow up on this finding in the wake of the Russian invasion of Ukraine.

Finally, we turn to some of the policy implications of these empirical observations and analytical findings. For now, design variations in national ISMs reflect important differences among countries with respect to how governments interpret essential security threats, different legal traditions, and what governments and civil society view to be the appropriate balance between open markets and state intervention. The effects of these ISMs on both the internal market and the EU's openness to external actors will depend on key design and implementation features of these new regulatory authorities. An open question is how much institutional convergence we can expect between these national ISMs as the EU's own screening mechanism gets more experience and forces regular cooperation between member states screening authorities, and as investment screening cooperation with the United States intensifies, notably through the EU-US Trade and Technology Council created in 2021.

Another important policy implication is how the expanded practice of investment screening will alter the EU's understanding of the benefits and vulnerabilities of open markets. We have argued that contemporary European ISMs were not designed as protectionist instruments. They were created out of genuine concern about national security, rather than protectionist demands from special interests. At the EU level, investment screening was created as part of a new toolbox of trade and investment policy instruments designed to ensure Europe's open strategic autonomy. The creation of these new instruments may be a shift in strategy, but the goals of the EU have for now remained the same: free and fair rules-based trade and investment. However, it would not take much for some of these instruments, including investment screening, to be used as part of an industrial policy strategy or protectionism. The evolution of investment screening outside of Europe, as well as domestic politics in the member states, will determine whether ISMs remain governed by a national security rather than an economic logic in the years to come.

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DATA AVAILABILITY STATEMENT

The PRISM Dataset is available for academic use upon request. Please fill out the form at https://investmentscreening.princeton.edu.

ORCID

Sarah Bauerle Danzman https://orcid.org/0000-0003-2278-4259

ENDNOTES

[1] 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 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R0452&from=EN.

[2] Of course, the U.K. exited the EU on 31 January 2020. We include the U.K. in our analysis since it was in the EU for most of the period we review.

[3] An important exception is Finland, which developed a cross-sectoral mechanism in 1993 that also screened for broader economic purposes.

[4] Because the U.K. was no longer an EU member state in 2021, their ISM was not counted in this figure.

[5] These include: transparency of rules and procedures; non-discrimination among foreign investors; confidentiality of information exchanged; the possibility of recourse against screening decisions and; measures to identify and prevent circumvention by foreign investors.

[6] Though Spain allows for review of transactions in which a foreign government-controlled entity is an acquirer across any sector.

[7] Our preferred specifications do not index Chinese investment by GDP. This is because Chinese investment still remains a small percentage of overall FDI in Europe. Additionally, it is not clear if the size of Chinese investment is as important as its existence. For example, Chinese acquisitions in Germany have focused on modestly sized, but technologically sophisticated Mittelstand businesses. It is likely the case that policymakers and citizens are more worried by the number and visibility of Chinese investment rather than the size of such investment as a proportion of overall FDI. In robustness checks, we measure Chinese FDI by number of transactions and our results are substantively similar. When we index Chinese FDI by GDP, our results are no longer statistically significant. We report these results in the Appendix S1, but we do not think that the relative size of Chinese investments to overall inward FDI is the best way to operationalise growing concern over Chinese FDI.

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[8] For countries with sectoral screens, this measures the number of technology sectors for which the government has the authority to screen investment. For countries with cross-sectoral screens, this measures the number of technology sectors for which the government has enhanced review authority.

[9] See Lenihan (2018) for another important corrective to this perception. Lenihan argues countries use investment screening for non-military internal balancing and are willing to do so against allies as well as adversaries.

[10] See, for example, briefing statements related to the U.S.-EU Trade and Technology Council: https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/29/u-s-eu-trade-and-technology-council-inaugural-joint-statement/.

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AUTHOR BIOGRAPHIES

Sarah Bauerle Danzman is Associate Professor of International Studies at Indiana University Bloomington. She is the author of *Merging Interests: When Domestic Firms Shape FDI Policy* (Cambridge University Press, 2019) and many articles published in outlets including *Foreign Affairs*, *International Studies Quarterly*, *Perspective on Politics*, *Review of International Organizations and Review of International Political Economy*.

Sophie Meunier is Senior Research Scholar at the Princeton School of Public and International Affairs, Princeton University. She is Director of the Program in Contemporary European Politics and Society and Co-Director of the EU Program at Princeton. She is Chair of the European Union Studies Association (2023–2024). She is the author and editor of many books on Europe and globalisation, including *Trading Voices: The European Union in International Commercial Negotiations* (Princeton University Press, 2014).

SUPPORTING INFORMATION

Additional supporting information can be found online in the Supporting Information section at the end of this article.

Appendix S1.

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