

Foreign Investment in the European Union



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Europe and Foreign Investment

- Europe receives major inflows of foreign investment, partly in the form of direct investment (FDI) and acquisitions
 - Highly beneficial economic effect
 - Competition among territories to attract FDI
 - Market for corporate control increases corporate value and competitiveness
 - Creates employment and output
 - World-wide FDI in 2008 down 20%
- ⇒ Importance to keep an open and non-discriminatory approach, both intra EU as well as extra EU
- ⇒ Financial and economic crisis has the potential to raise protectionism
- ⇒ Let's look at the policies....How open is Europe?

1. Competition Policy

- Merger Control
 - EU Commission has resisted national protectionism (national champions)
 - Some exceptions (military)
 - International dimension more and more important (the ICN)
 - State Aid Control
 - Big success inside the EU (unique governance)
 - the impact of the financial and economic crisis => softening of state aid rules?
 - Danger of international subsidy wars
- ➡ Better international governance needed
- ➡ Germany most to lose from subsidy wars

2. Trade Policy

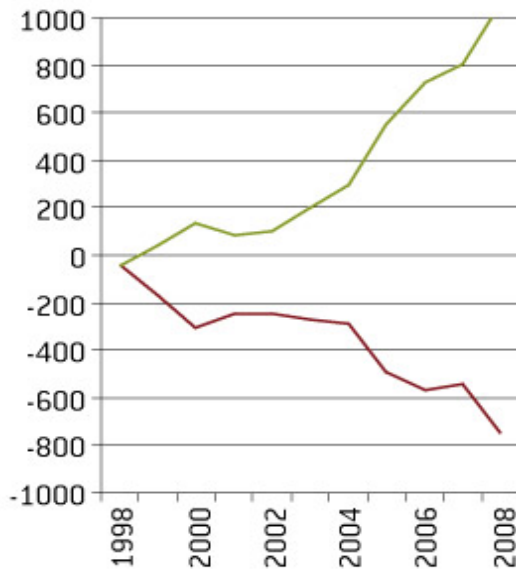
- financial and economic crisis leads to protectionist tendencies
 - Germany a big exporter => likely to suffer most from protectionist tendencies and the financial and economic crisis
 - new US administration (as well as others) seem to have different priorities (due to the financial and economic crisis) => "buy american"
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- ☞ resist protectionist tendencies (inside the EU and outside)
 - ☞ WTO: complete Doha round => better than most stimulus packages

3. Foreign Direct Investment Policy

- Europe, especially Germany very open (OECD ranking # 3)
- But, more protectionist sentiments emerging (SWF, critical infrastructure, "Locusts")
- Changing patterns of investment
 - Wave of investments in Western Finance (2007-08)
 - Rising presence of emerging countries
 - Higher presence of 'sovereign investment'
 - Ultimately controlled by governments
 - Includes, but not limited to, Sovereign Wealth Funds (SWFs)
 - Different than past globalization waves
- Policy Report (Nov 2008), Röller and Veron
"Safe and Sound: An EU Approach to Sovereign Investment"

Political Diversity of Current Surpluses...

All countries
[Aggregate current-account balances in US\$bn]

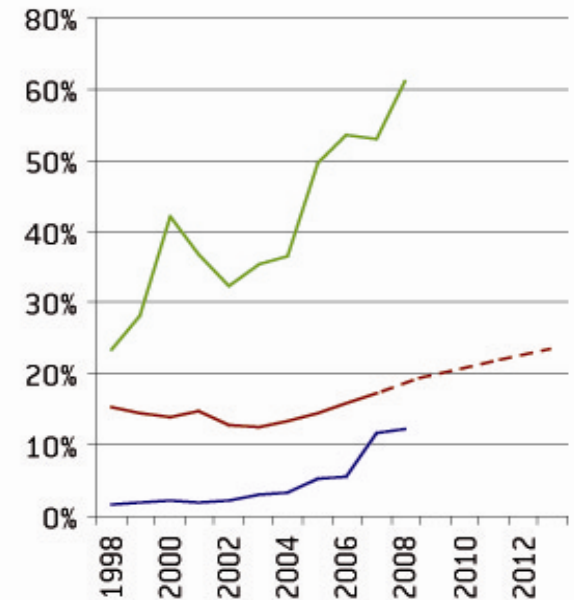


— Countries classified 'free' — Other countries

Countries with current-account surpluses
[Aggregate surpluses as % of world GDP]



Share of countries not classified 'free'

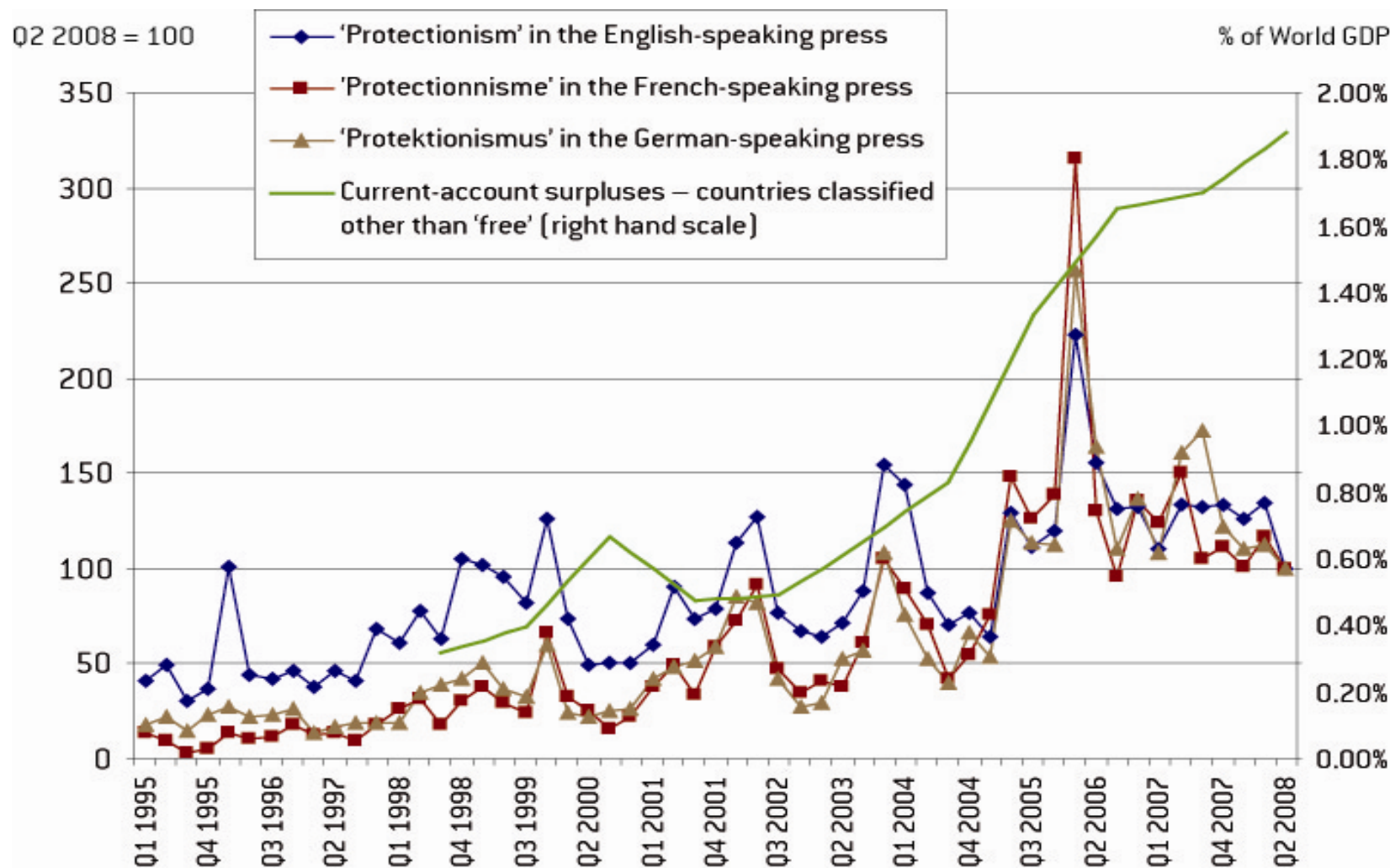


— Aggregate current- account surpluses
— World GDP [actual to 2007]
- - - World GDP [IMF forecast]
— Market value of FT Global 500 companies

...Mirrors Broader Economic Rebalancing
...FDI "not free" was € 14 billion in 2008 (all time high)

Source: IMF (current-account data); Freedom House (regime classification); FT Global 500 rankings

Protectionism Is More Present Than Ever



Source: Factiva, IMF, Freedom House

The Risks

- 'Macro' risk
 - Foreign (sovereign) investors could destabilize markets
 - Controversial, no clear evidence; warrants further research
- 'Micro' risk
 - Foreign (sovereign) investors could leverage economic influence to achieve political objectives or inflict harm (Gas pipeline)
 - Not frequent, but possible
 - Not a long-term investor
 - No evidence on SWF
- Counterpart risk of protectionist drift
 - With harmful economic (and security) effects

👉 **Need to balance those risks**

National Responses - Germany

Different approaches in Europe

- German law about to be reformed (SWF, critical infrastructure)
 - previously only military/sensitive data
 - 25% of foreign ownership (non-EU, non-EFTA)
 - Lean process:
 - 3 months investigation, 2 months period thereafter
 - later interventions not possible
 - Firms can get legal certainty in advance of purchase
 - Public order or public security (high standards by European Courts)
- ☞ New German law still very open (compared to other EU countries, US, Russia, etc.)
- ☞ no “strategic” industries (France)
- ☞ However, not clear what the criteria are (likely to be challenged by EU courts)
- ☞ danger of various diverging approaches across Europe

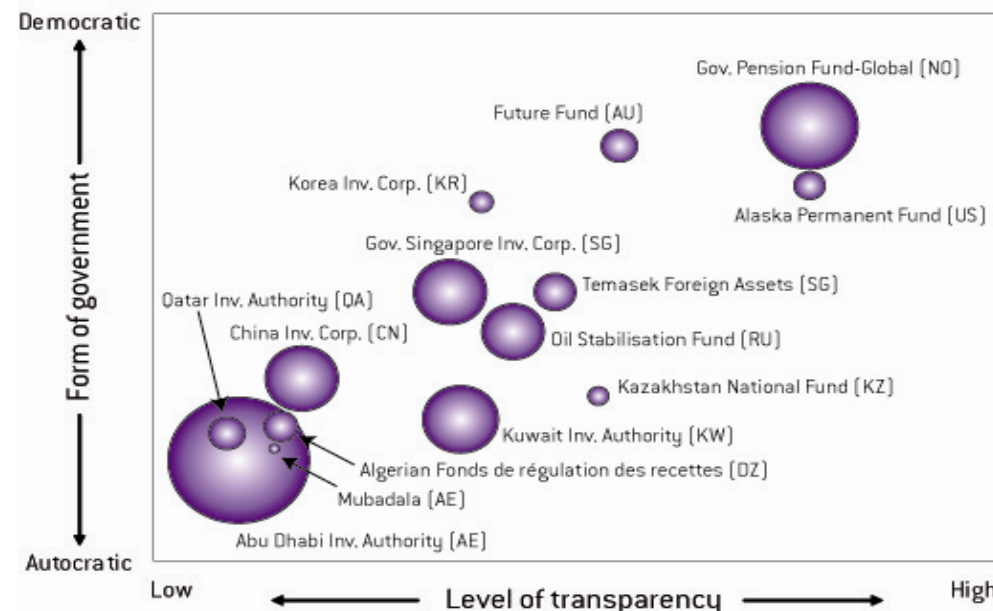
Multilateral initiatives

- 'Santiago Principles' (IMF, Oct. 2008)
 - Very good effort – transparency and governance issues (art. 19.1 “other than economic”)
 - Issue: Implementation and sanctioning => soft law (like ICN)
- OECD: G7 mandate (report by mid-2009)
 - National security legitimate, but needs to be ring fenced

BUT: Implementation/Sanctioning

- Tension with Domestic Political Regimes (transparency)
- Incentives not to comply
 - Political / financial
- Limited Western leverage

👉 Europe can/needs to do more



Policy Options for Europe

- Security assessment of foreign acquisitions intrinsically "national "
- Key Requirements on review process
 - Openness + legal certainty
 - Comprehensiveness => no policy gap (trade and competition policies not enough)
 - Sustainability => no slippery slope
- Policy options
 1. National legislation and implementation
 2. EU legislation, national implementation
 3. EU legislation and implementation

☞ Option 2 best

- i. EU framework legislation + coordination (lean process, legal certainty, hard criteria, sanctioning mechanism)
- ii. national implementation (national security)

☞ Same applies, in principle, at the global level

Conclusion

- financial and economic crisis leads to protectionist tendencies
 - over- regulation, trade barriers, subsidies, investment barriers
- resist protectionist tendencies (inside the EU and outside) by better international economic governance
 - Merkel proposal of a world economic council
 - OECD, IMF, WTO, GXY
- Example: complete Doha round successfully is better than most stimulus packages

A small yellow arrow pointing to the right is located in the top left corner.

Thank You For Your Attention