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Outbound FDI control: a new economic security tool for the European Union?

by
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On January 24, 2024, the European Union launched an initiative to explore possible restrictions on certain investments by European firms abroad. The prospect of controlling outbound FDI was, until recently, unthinkable. However, the EU has lately undergone a geoeconomic turn through which the European Commission and member states have reexamined the security implications of economic interdependence. The EU implemented an inbound FDI screening framework in 2019, an anti-coercion instrument n 2023 and is modernizing approaches to export controls, foreign subsidies and procurement practices. Yet, none of these tools fully address the security risks posed by outbound FDI through which competitor countries could obtain dual-use technologies and related know-how for military and surveillance purposes.

The Commission first signaled its interest in outbound FDI controls in President Ursula von der Leyen's March 2023 speech on EU-China relations. In June 2023, the Commission released its EU Approach to Enhanced Economic Security. The strategy outlined three policy pillars: "promote", "protect" and "partner" to minimize "the risks arising from certain economic flows in the context of increased geopolitical tensions and accelerated technological shifts while preserving maximum levels of economic openness and dynamism". An expert group of member state representatives and Commission officials was directed to evaluate gaps in existing trade security rules that might require outbound FDI restrictions. Since most EU member states do not monitor outbound FDI, a systematic assessment of the problem has been challenging. The January 2024 package included a white paper on outbound investments, outlining a gradual approach to possibly implementing such controls:

- A public consultation, to solicit stakeholder views, lasting until April 2024.
- A 12-month monitoring stage, starting summer 2024, to collect data on outbound investment flows.
- A risk-assessment stage, starting in autumn 2025, in which the Commission will analyze the data from the monitoring stage, to scope the size and nature of the policy problem. The Commission and member states would then determine whether and how to design an adequate and proportional policy response to any risks identified.

The Commission is not considering outbound FDI regulation in a vacuum. In Washington, D.C., policymakers have been working for over three years to develop their own investment controls. After failed efforts in Congress, the Biden Administration adopted, through a 2023 executive order, a notification and prohibition regime for US non-passive investments in China, Hong Kong and Macau for advanced semiconductor, quantum computing and military/surveillance-oriented artificial intelligence technologies. The US government has encouraged its allies and partners to enact similar measures. The war in Ukraine, China's growing alliance with Russia and the strengthening of an intra-EU sanctions bureaucracy have made the EU more receptive to outbound FDI regulations focused on critical technology rather than offshoring concerns. The May 20, 2023 G-7 Leaders' Statement on Economic Resilience and Economic Security acknowledged that certain kinds of outbound investments to countries of concern could endanger national security through the leakage of critical technology and know-how that is difficult to effectively manage via export controls. This reflects the EU's insistence that any outbound controls be narrowly restricted to critical technology.

The EU has a long path toward implementing restrictions on outbound FDI, and the January 2024 statement, which delayed the process, is not a *fait accompli*. Three policy concerns in particular need resolution:

- Get ahead of the potential dispute regarding competence over economic security. Following the controversial transfer of FDI policy to the EU level in the 2009 Lisbon Treaty, the Court of Justice of the European Union ruled in 2017 that the EU has exclusive competence over policy regarding FDI. This presumably also covers outbound investments. However, national security remains a member state competence. Actors opposed to outbound FDI control may challenge the EU's capacity to regulate over this issue.

- Ensure outbound rules do not conflict with other EU security-related regulatory instruments. Otherwise, actors could circumvent outbound controls by using loopholes or conflicts in related instruments.

- Finetune regulation and openness. Outward FDI is harder to regulate than inward investment, as governments must monitor the investment's ultimate destination,

> where they have no jurisdictional authority. The EU must enact rules that are sufficiently binding to prevent circumvention through indirect acquisition channels, while not being so strict as to make benign outbound FDI too burdensome. A regime that is too complicated to administer would risk undermining the global competitiveness and innovativeness of EU firms. These definitional issues, along with questions about appropriate enforcement guidelines to encourage voluntary compliance, have also slowed US efforts to finalize its rules.

The imposition of outbound investment restrictions would be both a substantial escalation of an EU geoeconomic agenda and a technically difficult policy to implement without undermining a general commitment to economic openness. The EU should approach this topic cautiously, so that it does not inadvertently kneecap EU emerging technology companies. Constructing targeted and effective outbound investment regulations is even more challenging than for inbound investment screening. A good starting point would be for the EU to apply the OECD principles for inbound screening—transparency, predictability, accountability, proportionality—to its approach for outbound regulation.

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