Position Paper

External Economic Policy/
International Markets

Expanding the Scope of Foreign Investment Screenings of non-EU Investors

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BDI position at a glance:

- Foreign investment is welcome in Germany. It creates wealth and jobs.
- The control mechanisms currently laid down in the Foreign Trade and Payments Act (AWG) and in the Foreign Trade and Payments Ordinance (AWV) are sufficient for the protection of public policy and security. We reject any extension of the control mechanisms to include “economic” criteria since these can open the floodgates for the misuse of protectionist instruments. However, the aim must be to improve the transparency and reliability of the screening procedure.
- The German Federal Government and the EU Commission must work towards ensuring unrestricted market access and fair competitive conditions. They must induce states with restricted market access to open their markets for trade and for investors. Free trade agreements (FTAs) and bilateral investment treaties (BITs) are appropriate instruments for opening markets.
- A general and evaluative differentiation between state and private agents in the case of foreign direct investment is very difficult in practice. The fact that an investment is facilitated by subsidies or is in line with the economic policy objectives of the country of origin is not in itself proof of its harmfulness.
- The potential dangers of “hostile takeovers” by foreign enterprises must be balanced against the core values of private property and the freedom of contract as cornerstones of the social market economy.
- In the course of a monitoring process, the European Commission should first gather reliable data on foreign investment entering the EU. This monitoring could lead to an evaluation and review process which would identify adequate political measures in the case of undesirable developments. An extension of the screening criteria for state intervention rights should only be considered as the very last resort.

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Background

In recent years there has been a significant increase in the number of German companies being taken over by foreign investors from emerging economies, from China in particular. In some cases these takeovers were met with great media interest (such as with *Kuka* and *Aixtron*). Taking China as an example, the amount of the country's direct investment in Germany and Europe is still at a very low level. Currently, only 0.5 percent of foreign direct investment in Germany comes from China. The stock of German investment in China exceeds this amount by 31 times.[1] However, the growth rates for Chinese investment in Germany have risen substantially in recent years (2014: 26.1 % as against 2013, 2015: 39.7 % against 2014).[2] And the "Made in China 2025" strategy adopted by the Chinese government gives grounds for expecting an increase in strategically motivated foreign investment from China.

Direct investment (2015)*

	German investment in China	Chinese investment in Germany
Investment stock (bn. euros)	69.6	2.2
Number of companies involved	2.044	101
Persons employed (thous.)	701	12
Foreign turnover (bn. euros)	262.0	3.8

Foreign trade (2016)**

	German exports to China	Chinese exports to Germany
Trade in goods (bn. euros)	76.0	93.8

* Deutsche Bundesbank, *Bestandserhebungen über Direktinvestitionen. Statistische Sonderveröffentlichung 10*, <http://g8fip1kplyr33r3krz5b97d1.wpengine.netdna-cdn.com/wp-content/uploads/2017/03/2017-03-20-Draft-Union-Act-on-Foreign-Investment.pdf> (as of 16.05.2017). ** Statistisches Bundesamt, *Außenhandel. Rangfolge der Handelspartner im Außenhandel der Bundesrepublik Deutschland*, <https://www.destatis.de/DE/ZahlenFakten/GesamtwirtschaftUmwelt/Aussenhandel/Tabellen/RangfolgeHandelspartner.pdf?__blob=publicationFile> (as of 16.05.2017).

The increase in investment from China fueled the political discussion on whether the current possibilities for state intervention in the activities of foreign investors in Germany are sufficient. Both existing German and European law already offer opportunities for dealing with possibly harmful investments. In the course of a sector-specific investment screening (§ 5 paragraph 3 AWG in conjunction with §§ 60ff AWV) the state can intervene, such as in the case of investment in the field of weapons of war. Moreover, the Foreign Trade Act (§§ 4 para. 1 subsection 4 AWG in conjunction with § 55 ff. AWV) permits the Federal Government to prohibit or to restrict holdings in German enterprises by investors from outside the

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[1] There can be wide divergences in the figures on foreign direct investment in Germany and Europe, depending on the institution and the recording method. The official figures of the German Bundesbank often do not adequately reflect current trends since they are published with a delay of over two years. According to a study by MERICS and the Rhodium Group, Chinese direct investment in Germany in 2016 amounted to around 18.8 billion euros. MERICS/Rhodium Group, <https://www.merics.org/ueber-uns/merics-analysen/papers-on-china/cofdi/cofdi2017/>, MERICS Papers on China: Chinesische Direktinvestitionen in Deutschland und Europa (accessed 30. March 2017).

[2] Deutsche Bundesbank, *Bestandserhebungen über Direktinvestitionen. Statistische Sonderveröffentlichung 10*, April 2017, <https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Statistische_Sonderveroeffentlichungen/Statso_10/2017_bestandserhebung_direktinvestitionen.pdf?__blob=publicationFile> .

EU, if, as a result of the acquisition, a threat could be posed to the public order and security of the Federal Republic of Germany. This presupposes that an actual and sufficiently serious danger exists which affects a basic interest of society (§ 5 para. 2 p. 2 AWG). In this case the Federal Government must arrive at a decision within three months after the takeover. During the initial stages of the proposed investment the business partners have the opportunity to obtain a certificate of non-objection (§ 58 AWV) from the Federal Ministry of Economics (BMWi). It is thus possible to avoid damages to the reputation of the involved companies.

As a consequence of the increase in Chinese investment in Germany, there have been initiatives not only at national level and the level of Germany's regional states but also at EU level to expand the investment screening by the governments:

- In October 2016 the existence became known of an internal paper of the Federal Economics Ministry entitled "Key Points for a Proposal for Investment Screenings at EU Level"[3]. In the paper the ministry recommends that the EU should bestow on the member states the power to forbid investment by investors from outside the EU.
- On January 31, 2017 the regional state of Bavaria submitted a motion in Germany's second parliamentary chamber, the Bundesrat, which pursues the same political objective, aiming at expanding state influence on foreign direct investment in Germany.
- In February 2017, in a letter to the European Trade Commissioner Malmström, the three EU economies Germany, France, and Italy requested the adoption of political measures intended to bring about greater reciprocity in the case of foreign direct investment and in the awarding of public procurement contracts with regard to non-member countries.
- In March 2017 deputies from the European People's Party introduced a motion in the European Parliament calling on the European Commission to issue stricter rules governing the purchase of European enterprises by foreign investors.[4]

On the one hand, those who advocate for tougher state investment control see the innovative capacity and future viability of the German and/or European business sector as being jeopardized by strategic and frequently state-promoted investment from abroad in firms providing top technology. There is a fear that foreign direct investment from countries pursuing a committed industry policy agenda could lead to an uncontrolled drain of technology and jobs. On the other hand, by boosting their own intervention rights they want to prompt other states to go further in opening up their markets (reciprocity).

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[3] „*Eckpunkte für einen Vorschlag zur Investitionsprüfung auf EU-Ebene*".
[4] European Parliament, *Proposal for a union act on the Screening of Foreign Investment in Strategic Sectors*, 20 March 2017, <http://g8fip1kplyr33r3krz5b97d1.wpengine.netdna-cdn.com/wp-content/uploads/2017/03/2017-03-20-Draft-Union-Act-on-Foreign-Investment.pdf>.

In some industry sectors there is also growing anxiety at unequal competitive conditions. However, experience to date with foreign investment in Germany offers few grounds for concern. The statistical data currently available on Chinese investment in Germany does not provide evidence that would justify fears of a loss of competitiveness and of a technology drain. On the contrary, openness in Germany and Europe is an important factor in the success of German industry. Furthermore, Germany's credibility as the champion of open and free markets should not be jeopardized by political measures which could be interpreted as protectionist. After all, in the battle against protectionism, which is of great importance for the success of German industry, this credibility is of key importance. This has recently been given special emphasis both by the BDI and by the German government within the framework of the B20/G20 process.

BDI position

- Foreign *investment is welcome in Germany*. It creates wealth and jobs in Germany. Foreign investors also have to comply with the rules that apply here. The promotion of free competitive conditions should be accomplished by bilateral negotiations and not by means of one-sided restrictions on access to the EU. Careful consideration must be given to evaluating whether extending the intervention rights of the state in corporate takeovers can be justified. Changing the political rules with this aim in view requires unprejudiced analysis on the basis of a reliable set of data.
- The *control mechanisms* currently embedded in *the Foreign Trade Law* (AWG) and in the Foreign Trade and Payments Ordinance (AWV) *are sufficient* to protect the public order and security. The protection of public order and security has worldwide acceptance as a motive for investment screenings by governments. In addition, the general laws for regulating the economy (e.g. laws against restriction of competition or against unfair competition) prevent a negative impact of corporate business activities. In addition, regulations governing export controls prevent the export of technology which could endanger Germany's national security.
- A fundamental broadening of the screening criterion "protection of public order and security" in AWG and AWV to include *economic criteria*, which could in practice possibly be motivated by the interests of industrial or technology policy, can open the door to being exploited as a protectionist instrument. Such criteria are hard to define and are very unlikely to be practicable. If applied, it must only be in relation to cases when a major market distortion at home is to be expected as a result of support for the foreign investor that is clearly state-promoted.
- The *transparency and reliability of the screening procedure* should be improved. A more transparent and precise definition of what is to be understood by "national security and policy" in the context of foreign direct investment can improve the legal security for investors and thus

benefit Germany as a target for investments.[5] In the process, any modernization of screening procedures must not give rise to increased bureaucratic burdens for enterprises. Any enlargement of the areas of the economy to be screened must be strictly guided by the protection of national order and security.

- A general and *evaluative differentiation between state and private agents* with reference to foreign direct investment faces serious difficulties.[6] The fact that an investment is backed by subsidies or is in line with the economic policy objectives of the country of origin does not in itself constitute proof of its harmfulness for the recipient country's own economy. At the same time, the Federal Government and the European Commission should work to ensure as far as possible that state subsidies or other support measures do not distort competition.
- The BDI welcomes political initiatives for the dismantling of restrictions on investment, combating protectionism and eliminating restrictions in public procurement in German industry's markets abroad. The Federal Government and the EU Commission must work towards persuading *states with restricted market access to open their markets*. This is all the more essential in view of increasing protectionism around the world. However, the threat to introduce market access restrictions for foreign investment ("reciprocity") can hardly be judged as likely to induce such states to open their markets. BITs and FTAs are appropriate means for opening up foreign markets for investors.
- The *danger of "hostile takeovers"* of German companies by foreign companies is currently *low*. Around 95 percent of all companies in Germany are family-owned and cannot be taken over against the will of their proprietors. Decisions by owners as to whom they can sell their stake in the firm should not be restricted any further than at present. Property rights and freedom of contract must be guaranteed and strengthened as cornerstones of the social market economy in Germany. The BDI rejects politically motivated decisions regulating which investment from abroad is considered positive or negative for Germany as a business location.
- In a *monitoring process*, the European Commission should gather reliable data on investment activity in Europe (flows, funding, conduct of investors after the takeover, how close investors are to the state etc.).[7] This monitoring should lead to an open-ended process of evaluation and review to identify possible adequate political measures

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[5] 99.7 of investment screenings in Germany were not initiated by the Federal Government but by the investors themselves, some of whom were in a state of uncertainty. Particularly security-relevant areas such as crypto-technology or network operations (telecommunications, electricity, gas) could in some cases be listed as industrial branches subject to approval.
[6] Sovereign wealth funds are to be found in numerous countries, e.g. in China, Kuwait, Qatar, Norway or Singapore.
[7] This is all the more relevant against the background of strengthening the principles laid down in the TRIMs (Trade Related Investment Measures) agreement within the WTO (e.g. in the field of forced transfer of technology). Here the monitoring could also make use of the fact that today there is already an obligation to disclose information, e.g. relating to corporate technology licensing contracts vis-à-vis non-member countries.

in response when undesirable developments are detected. The monitoring itself could possibly have a disciplinary effect. Criteria determining misconduct and adverse developments have to be defined precisely (e.g. “market distortion”, “state support of foreign investors”), in order to curtail any arbitrariness and insecurity. The monitoring should be carried out without additional disclosure obligations being imposed on enterprises. An expansion of the screening criteria for state interventions should be considered only as the very last resort.