POSITION PAPER

12 March 2008

FREEDOM OF INVESTMENT – AN OBJECTIVE FOR EUROPE

Summary

This paper outlines BUSINESSEUROPE's position in the debates surrounding foreign investments in Europe by calling for freedom of investment in the EU and abroad. Open investment regimes are fundamental to the competitiveness of companies and the European economy as a whole.

Supporting international negotiations for freedom of investment: Throughout this discussion, the EU should keep its international investment objectives in mind – notably the pursuit of providing more access and better protection for European investors in third countries.

Concern over far-reaching investment restrictions: BUSINESSEUROPE has serious concerns over proposals to create a Committee on Foreign Investment in the United States or CFIUS-type review procedure to vet foreign proposals for mergers and acquisitions.

A risk-based, proportionate response to well-documented concerns: To move forward cautiously, while recognising the reality of current dispensations or arrangements, BUSINESSEUROPE first suggests that any legislator concerned with the issue thoroughly analyse the claimed risks associated with foreign investments to see whether new investment measures are needed. If there are demonstrable risks associated with foreign investment, the responsible authorities should carefully examine appropriate and proportionate policy responses to address them whilst preventing any unwarranted and unjustified fragmentation of the EU Single Market or unjustified government intervention in legitimate merger and acquisition activities.

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Introduction

The rise of foreign direct investment (FDI) is one of the most salient features of globalization. In 2005 alone, global FDI figures rose 9%. Increasing levels of international trade, the internationalisation of production processes and the continuing development of global capital markets all contribute to this trend. Nonetheless, in recent months, the issue of placing limits on certain types of foreign investment due to concerns about the control of strategic national assets by foreign companies and/or governments has been mooted in Europe.

Over the summer of 2007, a number of European governments and European Commissioners expressed concerns about certain types of foreign investment in European industries, not least from the growing number of Sovereign Wealth Funds or state-controlled companies from emerging economies. As a consequence, calls for legal mechanisms at different levels to review foreign investments - similar to the US Committee of Foreign Investment (CFIUS) - have been heard. Although control mechanisms for foreign investment already exist in some Member States.

Fear of certain kinds of foreign investment is in no way limited to Europe. A more sceptical attitude towards certain foreign investors is also developing in the US and in many emerging countries. There is a global trend toward investment protectionism and in some foreign countries, European and other foreign companies have recently suffered from discriminatory treatment or de facto expropriation.

Therefore, open flows of both inward and external investment are fundamental to the competitive performance of European based companies and of the European economy as a whole. While national security concerns and risks related to the behaviour of new and powerful players in the international economy should by no means be underestimated, there is no doubt that Europe - as one of the main benefactors of open markets and heavily dependent on capital from foreign investors - needs to act with caution.

Further restrictions on foreign investment in Europe should only be considered if risks are real and serious and if those risks cannot be addressed through existing policies, such as competition, prudential or general interest rules. Unjustified shifts in the "rules of the game" could undermine confidence in the EU and send the wrong signal to third country investors. When deciding about the treatment of inward investments, legislators also need to take into consideration their strategic interest to pursue an open investment strategy to try to remove barriers to EU investments in third countries.

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Before any action is taken on foreign investment, BUSINESSEUROPE calls for a thorough analysis of Europe's interests in this field. The perceived risks and the response to these risks should be examined carefully, and the outcome should be balanced against the EU's overall interest in securing a freer global investment climate for the future.

I. Pursue Europe's international investment interests

When discussing Europe's fundamental interests in relation to international investments, it is important not to focus solely on a defensive inward-looking approach. As the world's most open economy, dependent on free trade and investment flows for its present as well as future wealth, Europe should be aware of its priorities. By putting too much emphasis on defensive interests, EU Member States might lose sight of - and credibility in pursuing – their external interest in opening up foreign markets for investment by European companies. The most important goal for European industry should remain to push access for and protection of its own investments aboard. Better investment chapters in EU free trade agreements, in line with EU and Member State competences specified in the Treaty, could strengthen the position of European companies in third countries.

In this context one should also carefully consider the demand for reciprocity as a way to create equal and fair operating conditions in the EU and foreign markets for European and foreign companies. Restricting access to the EU market in order to strengthen the EU's negotiating position towards third parties could trigger a downward spiral of protectionism.

It is therefore essential that the EU and its Member States - in parallel to national security considerations - pursue an offensive strategy in removing barriers to investments in third countries. Such a strategy should not only raise the stakes in multilateral and bilateral trade negotiations, but also comprise an active economic policy, including a political dialogue with emerging countries on topics such as transparency of Sovereign Wealth Funds (SWFs). Effective solutions to create a global level playing field can only be found at the international level. Therefore EU Member States should engage in ongoing discussions in international fora such as the G-8, OECD and IMF.

II. THE CLAIMED RISKS

BUSINESSEUROPE recognises the legitimate right of EU Member States to guarantee national security – including in the investment field. However, this right must be exercised in a transparent manner, within the confines of Single Market rules and other international legal obligations, and on the basis of a clear definition of security risks. Three main risks have been raised in European debates on foreign investment.

a. The concept of strategic industries

When observing debates in Europe and elsewhere over the risks related to foreign ownership, it is clear that a stronger focus on security concerns lie behind the review of investment control regulations - or the scrutiny of individual merger and acquisition cases - in a number of countries. Most countries define their defence industry as a

strategic sector. The jurisprudence of the European Court of Justice (C-483-99; C-509/99) suggests that in particular energy supply security could be a strategic issue as well. An increasing number of countries are also adding many other sectors including the financial sector to that definition. This is a worrying trend for business.

With the rise of emerging economies, the concept of national strategic interest seems to be expanding further. In some case, policy makers are invoking the need to protect local economic interests in sectors that can hardly be said to have much bearing on national security or be of real strategic national interest (e.g. soft drinks). It is clearly not in the interest of European business to support unjustified and expansive definitions of strategic sectors in Europe and abroad.

b. New types of investors

The worry about risks related to foreign investors also seems to be shifting from the investment object to the identity of the investing entity. New investors from emerging economies are sometimes looked at with scepticism. Companies or funds with close links to foreign political regimes are suspected of making investments for political motives, of not playing by the rules of a market economy and not applying the same high standards of corporate conduct as OECD based companies. The growing importance and specific behaviour of Sovereign Wealth Funds (SWFs) seem to constitute a focal point in the present European debate.

SWFs are government-controlled investment funds created to maximise returns on the large foreign exchange reserves enjoyed by some countries as a result of high commodity prices or strong comparative advantage. It should not be forgotten that SWFs have been active investors globally for decades and that many European companies have had particularly good experience with SWFs, which have generally been considered reliable, long-term investors. To date, most SWFs have only held minority shares of companies – a fact that lends little credence to the suspected political motives of these funds.

On the other hand, the volume of assets that SWFs possess and invest now, and their rising number, is causing political concern. These funds, based in 30 countries worldwide (both developed countries like Norway and emerging economies such as China and Saudi Arabia), manage a total financial volume of over €1600 billion. The discomfort ranges from nervousness about the stability of the financial markets and the crowding-out of private investors by state-controlled players, to the specific behaviour of individual SWFs. However, serious analysis of the role of SWFs is distinctly lacking. While SWFs operate in different ways, there could be a case for greater transparency.

c. The energy sector

Fears of the influence of non-EU investors are especially strong in the energy sector. As part of the ongoing effort to liberalise the European energy market, the Commission is discussing mechanisms that could be used to limit the possibility of a potential "post-unbundling" control of networks by extra-EU companies, sometimes acting under direct government control. It is feared that a vital network industry, and more importantly that

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the European energy sector, could end up re-nationalised in the hands of a non-European state or a state-controlled monopolist.

III. Act on facts rather than fear

However serious the worries and suspicions towards certain foreign investors might appear, it is important to underline that capital markets offer no means of differentiating between market participants according to their economic and/or political intentions. Restrictions will apply to - and possibly dissuade - all investors alike. It should also not be forgotten that the overall interest of Europe is to attract foreign investment - and to secure free access and protection for its own investments abroad. BUSINESSEUROPE, therefore, calls for caution and analysis before action is taken. Any investment rules should first of all be based on clearly identified risks.

One question concerns the definition of what constitutes a strategic industry. As regards the core sectors of military security (armaments) and confidential state interests (crypto technology), EU Member States already have the right to oversee foreign investment in companies involved in these sensitive areas of activity. In addition, EU and national export controls rules play an important role in preventing foreign governments from gaining control of these technologies.

Careful consideration should be given as to whether the assumptions and suspicions about investment from SWF's and state-controlled enterprises are well founded. To date, evidence of politically motivated investments or abuse of foreign ownership in the EU is not convincing. Similarly, the risk of re-nationalisation through foreign state-ownership would be limited through a strict enforcement of EU competition rules.

Outside the core sector of national security, much greater justification for investment restrictions must be provided before any decisions are made.

- Broad, cross-sector restrictions should be rejected.
- The strategic significance of each sector should be justified individually as a matter of principle.
- The risk of introducing new instruments that could be abused for protectionist policies due to public pressure should also be well thought-out.

IV. Proportionate responses

If, after having analysed the risks carefully, any legislator concerned identifies a need for well defined national security reasons, appropriate responses should be considered carefully to ensure that they are proportionate with their objectives, within the rules of the EU Single Market and international trade and investment obligations.

a. Review existing measures

It is inaccurate to claim that the EU does not have any restrictions or measures governing foreign investment. First, all EU regulations apply equally to foreign and domestic investors which severely restricts the possibility for foreign investors to harm the national security interests of an EU Member State. Second, many existing regulations at both EU and Member State level contain prudential (for financial

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services) or public service (for network industries and natural monopolies) requirements that would render foreign political control of European based companies futile. Third, the EU treaties and regulations, including merger and acquisition regulations, include national security clauses which enable individual Member States to protect a national security interest. Before any proposals for new foreign investment measures are made any legislator concerned should explain why current rules and regulations are insufficient to address potential problems.

b. Consider alternatives to new investment restrictions

A general investment control regime is the least favourable way to prevent undesired foreign control of certain economic sectors. Other, less radical, solutions such as competition policy to safeguard effective competition - or solutions based on company law instruments should be preferred after careful study.

In sectors characterized by specific needs, such as industries relying on transmission networks, specific solutions addressing these needs should also be considered. One example of such specific regulation is the proposal made by the Commission excluding third country investors from buying electricity or gas transmission systems (as opposed to energy operators) unless this is permitted by an agreement between the EU and the third country.

As regards SWFs, concerns over the opaque operations of some funds could be adequately addressed through guidelines promoting a higher degree of transparency. If information on capital resources, risk development, control mechanisms and internal governance standards were available, much of the fear associated with SWFs would disappear. Such transparency guidelines should be sought in a multilateral context such as the OECD or the IMF as proposed in a recent European Commission Communication on the matter.

Finally, it should be stressed that alternatives to an investment control regime are important to consider also because existing legal obligations could make it difficult for any legislator to introduce investment restrictions. Both internal EU provisions and obligations at WTO and bilateral level would make a control regime complex for both governments and companies to understand.

c. Targeted and measured investment regulation

If, after having considered both the risks and alternative ways of regulation, it is nevertheless deemed necessary - and legally feasible - to introduce or maintain national investment control regimes, at the Member State level the specific criteria would also be of importance.

Measures should be transparent, proportionate and the anticipated benefits should justify the costs involved. Fundamental aims and intentions should be explicitly specified. Information about the planned review methods should be provided, as the resulting political decision must be predictable for investors.

The market intervention may not be the cause of, or result in, unwarrantable or arbitrary discrimination, nor may it be used as an excuse to restrict international

investments. It is also very important that all decisions taken should be fully legally challengeable before the courts.

Finally, any procedures to regulate or review foreign investments should be based on subsequent approval following registration and not on prior authorisation.

d. Guidelines on the application of Art. 58 para.1b of the Treaty

Whereas an EU investment regime may be legally difficult, there is still a possibility for exploring EU level work. In particular the Commission could provide guidance on the interpretation of Article 58 par. 1b EC which allows for restrictions of the freedom of capital movement for reasons of public order and security. Here the Commission could play an important role by creating a level playing field and legal certainty for the interpretation of Art. 58 par.1b EC Treaty as the Commission has done in other areas (see for instance Communication of the Commission on the application of Art. 296 EC in the area of defence procurement; COM(2006)779 final).

However, BUSINESSEUROPE insists that guidelines be based on relevant ECJ jurisprudence to ensure that any guidance will prevent possibilities for an unjustified fragmentation of the Single Market. The objective of such guidelines should be to clarify the scope and limits of national security restrictions available to EU Member States, while strengthening transparency and predictability for investors. The latter should be able to invest with minimal State interference. In addition, such guidelines should serve to facilitate the enforcement of the Single Market by speeding up Commission infringement procedures against protectionist abuses and possibly by enabling the Commission to suspend unwarranted obstruction of legitimate mergers and acquisitions by national authorities. Clarification could also facilitate EU negotiations of investment treaties or chapters of free trade agreements with third countries.