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INTEGRATION BY STEALTH:
HOW THE EUROPEAN UNION GAINED COMPETENCE OVER FOREIGN DIRECT INVESTMENT

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Abstract: How are policy competences allocated between different actors? This paper contributes to the literature on political development through an in-depth case-study of the conditions under which the competence over foreign direct investment (FDI) was transferred from the national level to the European Union (EU) in the 2009 Lisbon Treaty. Most analysts assume that this competence shift was a rationally designed delegation, intended to maximize European bargaining power in international investment negotiations, and conceived as an important element of a teleological drive to make the EU a meaningful external actor. This paper tells a different story--one where the competence shift happened by stealth as a result of a combination of Commission entrepreneurship and historical accident, against the preferences of the Member States. The paper also assesses whether the conditions under which the competence was transferred have implications on the implementation of the new policy.

Keywords: BIT; Common Commercial Policy ; Convention; EU; FDI; investment ; Lisbon Treaty; single voice

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How are policy competences allocated between different institutional actors? Do competence shifts result from rational design, historical accidents, or clever political entrepreneurship by specific actors? This paper contributes to the literature on political development through an in-depth case-study of the political conditions under which the competence over foreign direct investment (FDI) was transferred from the national level to the European Union (EU) in the 2009 Treaty on the Functioning of the European Union (TFEU, hereafter referred to as the Lisbon Treaty), which folded FDI under the Common Commercial Policy (CCP).

This new EU competence over international investment policy is, on the face of it, a radical change with potentially massive implications since the EU is the first sender and the first recipient of FDI worldwide. The EU can now theoretically take over the negotiation of all international investment agreements for the Member States in order to liberalize foreign markets and protect European investments abroad, and it can harmonize the rules governing the establishment of foreign investments inside the EU. Since the entry into force of the Lisbon Treaty in December 2009, the European Commission has prepared a series of communications and regulations to translate the new legal competence into implementable policies. The European Parliament, which was granted new powers of approval or rejection of all trade and investment agreements under the Lisbon Treaty, has produced several reports and resolutions on this issue. The EU will soon launch the negotiations of a Bilateral Investment Treaty (BIT) with China, the first under the new competence.

Scholars of FDI are now busy dissecting the implications of this radical change. Lawyers are finessing how competences are really divided between the EU and the Member States under the new regime (Bungenberg, 2011; Herrmann, 2010; Chaisse, 2012; Krajewski, 2005). Economists are asking how the new competence will affect economic growth and competitiveness (Blomkvist, 2011). Political scientists are exploring whether the new supranational competence will enable the EU to finally leverage its collective power of bargaining (Niemann, 2012; Meunier, 2013b).

What all these studies have in common is an assumption that this radical transfer of competence was a rationally designed delegation by the Member States, intended to maximize European bargaining power in international investment negotiations, and conceived as an important element of a teleological drive to make the EU a meaningful external actor. Instead, this paper argues, this radical shift, which ran counter to the preferences of the Member States and was not initiated by pressure groups, occurred by stealth and almost by accident. Consequently, because the Member States did not debate openly the supranationalization of foreign investment policy ahead of the institutional shift, it makes the implementation of the new policy more difficult, especially in the current general context, which is not conducive to the further creep of European integration.

How to explain the puzzling circumstances under which this radical competence shift took place in the face of opposition from almost all the Member States? This paper first explores three rationales for the competence shift: a response to the growing importance of FDI in globalization; a response to the institutional confusion created by the evolution of international investment negotiations in practice over the past two decades; and a response to the bargaining costs imposed on the EU and its Member States by cacophony. Section Two analyzes the diverging preferences of the main policy actors. Section Three retraces the historical steps that led to the stealthy inclusion of foreign direct investment under the Common Commercial Policy in the Lisbon Treaty and analyzes alternative explanations for why that shift was allowed to occur. Section Four assesses whether the conditions under which the competence was transferred have implications on the implementation of the new policy.

1. COMPETENCE SHIFT AS RATIONAL DESIGN

If we assume that states design international commitments rationally, as the “rational design” literature does (Koremenos, et al., 2001), then shifting the competence over FDI to the supranational level seemed like a rational decision for the EU as a whole for three main reasons: a response to the growing importance of FDI in globalization; a response to the institutional confusion created by the evolution of international investment negotiations in practice over the past two decades; and a response to the bargaining costs imposed on the EU and its Member States by cacophony.

A response to the growing importance of FDI in globalization

The 1957 Treaty of Rome, which created the European Economic Community, did not bring foreign investment policy under supranational reach, like it did for trade policy. FDI, not an important economic issue at the time, was ignored by the drafters of the treaty. While it might have made sense at the time, it no longer did after the 1980s when FDI started to grow very fast, both because of deregulation and because Bilateral Investment Treaties (BITs) decoupled between 1980 and 1999, jumping from 181 to 1,856 (UNCTAD, 2000). As a result, that period saw an explosion of FDI worldwide.

European countries were major actors of this explosion, both at the sending and receiving end. By 1999, companies based in the European Union accounted for two thirds of all investment outflows, and extra-EU FDI surpassed intra-EU FDI for the first time in 1997. Today, the EU is the world’s largest exporter of FDI, with over \$9 trillion in FDI stock abroad --twice as much as the U.S. stock abroad and almost half of the total value of FDI stock in the world (OECD, 2013). As for inflows, the EU is also the world’s biggest recipient of foreign direct investment.

It therefore seems like a rational and “natural” (Peterson & Ceysens, 2003) decision to update the EU rules governing international investment on market access, treatment standards, and protection in order to reflect the new reality of FDI in the economy and to protect European assets abroad (EU Parliament, 2010). According to DG Trade’s own words, “the EU's investment policy is focused on providing EU investors and investments with market access and with legal certainty and a stable, predictable, fair and properly regulated environment in which to conduct their business” (European Commission DG Trade, 2013). Similarly, a major EU Parliament report on the new EU approach to international investment policy after Lisbon states that “extending EU exclusive competence to include FDI now provides an opportunity to develop a common, comprehensive European Union approach to investment policy that can improve EU competitiveness and help obtain better access for EU investors in third markets; extend the protection afforded to EU outward investors beyond the existing member state bilateral investment treaties and promote EU norms in the field of sustainable investment” (EU Parliament, 2010).

A response to competence confusion

Although the formal EU rules governing international investment policy had not changed during the period of FDI explosion, however the practice of international investment policy in the EU became very complex, with some aspects dealt with at the supranational level while other aspects remained at the national level. It seemed rational to formalize the competence shift to put an end to the institutional confusion and legal uncertainty for foreign investors.

The Member States were solely responsible for negotiating and concluding their own BITs, which deal mostly with protection and post-establishment of foreign investment. EU countries had been particularly active in concluding BITs. By the time of the Lisbon Treaty, Member States had about 1200 extra-EU BITs with 148 countries, accounting for almost half of investment agreements in the world. Some countries, such as Germany, have more than 100 BITs. As for inward FDI, both the promotion and the vetting of inbound foreign investment have taken place entirely at the national level.

Nevertheless, competence for the negotiation of international investment agreements had “crept” to the Commission in practice for two reasons. First, trade and investment had become so intertwined that the EU had insidiously gained some practical competence over FDI policy as time went by because of its existing competence and “single voice” over trade (Meunier, 2005; Meunier & Nicolaidis, 1999; Elsig, 2002; Kerremans, 2006; Duer & Zimmermann, 2007). Even though the Member States were responsible for concluding their own investment agreements, the Commission did negotiate market access and pre-establishment conditions for European investments in the free trade agreements it was negotiating collectively, both multilaterally and bilaterally.

In multilateral trade negotiations, the EU Commission was in charge of negotiating the Agreement on Trade-Related Investment Measures (TRIMS), the General Agreement on Trade in Services (GATS), and the so-called “Singapore issues” –even if Member States contested in practice that delegation. Alongside the Member States, the EU was negotiating the Multilateral Agreement on Investments (MAI) in the OECD and is a member of the Energy Charter Treaty --a multilateral investment treaty with 47 contracting parties designed to protect investments in the energy sector. At the bilateral level, the EU has negotiated, and is negotiating, a plethora of comprehensive free trade agreements which include investment chapters on market access and protection (e.g. with South Korea, Mexico, South Africa, and Chile).

Second, the Commission had employed “stealth” measures since the 1980s to influence, regulate, and even vet FDI through areas in which it was formally competent, such as competition policy, trade defense instruments, and critical infrastructure (Van Den Bulcke & Zhang, 2013). The Commission could influence FDI through its competition policy, for instance by the enforcement of the rules on types and levels of state aid (which often involved foreign acquisitions or joint ventures with foreign partners).¹ Another competition instrument with FDI implications is the EU Merger Regulation (EUMR), in existence since 1989 and reformed in 2004 as part of EU competition law (European Council, 2004). The screening of foreign investments was certainly not the intent behind the merger instrument, designed to prevent harmful anti-competitive concentration of economic power, but it is an unintended consequence. In particular, acquisitions made in Europe by state owned enterprises (SOE) are subject to review, if they meet the size criteria (Van Den Bulcke & Zhang, 2013). Trade defense instruments, such as anti-dumping and rules of origin (many designed in the 1980s against the Japanese practice of investing to circumvent trade barriers), also shaped the investment decisions of foreign actors. Finally, the Commission could vet FDI through the 2006 European Programme for Critical Infrastructure Protection (EPCIP), which resulted from a 2004 initiative to combat terrorism (European Commission, 2006). This program stipulates that “critical infrastructure” --defined as systems and facilities needed for “maintenance of vital societal functions, health, safety, security, economic or social well-being of

¹ Many thanks to George Bustin for suggesting ways in which, in his legal experience, the Commission’s competence “crept” to FDI.

people”-- should be identified and protected via a “common minimum approach” (EU Council, 2008). Thus, the EPCIP permits the EU to vet foreign investment deals on national security grounds.

A response to the costs of cacophony

This formal cacophony, with each state negotiating individually, and the informal confusion, resulting from the juxtaposition of supranational and national responsibilities, was proving costly for European states. It thus seemed rational to eliminate these costs by shifting competence to the EU level.

The most obvious cost has been on bargaining leverage -- the absence of unison leading Europe to “punch below its weight” on at least two counts: market access and shaping the international context (Thomas, 2012; Elsig, 2013; Da Conceicao-Heldt & Meunier, 2013; Niemann & Bretherton, 2013). Because each Member State was negotiating on its own and could not make promises on behalf of the other Member States, it could not harness the market power of the whole EU by dangling the carrot of access to the entire Single Market and as a result force large economies to reciprocate by opening their own domestic market to foreign investment in return. Similarly, the EU has not been able to impose to the rest of the world its norms, values, and rules for fashioning international investment regimes in a way commensurate with its place as the world’s leading exporter and recipient of FDI (Bungenberg, 2011). Others, especially the NAFTA countries, have created *de facto* global standards for investment agreements, which the EU could not match, whether for human rights, labor standards, or sustainable development.

When it came to inbound investments, another cost has been the competition between Member States which this cacophony has induced. Countries, as well as sub-regional units (such as U.S. states), typically use a variety of financial and non-financial incentives to compete for FDI location: tax breaks and other fiscal incentives, infrastructure improvements, education and training assistance, flexibility and ease of bureaucratic procedures, etc. Unlike regional subunits, however, the countries of the EU are also competing with each other through regulatory and policy incentives. Formally, this competition can occur through national regimes for screening foreign investments, which can be more or less lax. Informally, this competition can take place through policies which are still national, such as labor standards (e.g. Greece turning a blind eye to labor violations committed by foreign investors), citizenship (e.g. Hungary granting automatic residency to those who invest 250,000 euros), and even foreign policy (e.g. leaders no longer meeting with the Dalai Lama in order to attract Chinese FDI) (Meunier, 2013a; Burgoon & Raess, 2013).

From the perspective of some individual Member States, this cacophony can be seen as a benefit. Countries can exploit their lax investment screening as comparative advantage to attract specific investors (such as China). From the perspective of the collectivity, however, this competition to attract foreign investment is costly if it leads to a regulatory race to the bottom. Moreover, the longer the cacophony remains the modus operandi in the EU, the denser the thicket of existing extra-EU investment agreements and the lower the incentives for third countries to renegotiate agreements with the collectivity instead. Delegating the competence over investment policy to the supranational level as soon as possible is expected to lead to more optimal outcomes (Meunier, 2013).

2. DIVERGENT PREFERENCES OVER THE COMPETENCE SHIFT

This section examines the preferences of the Commission, the Member States, and pressure groups vis-à-vis the competence shift. It shows that far from unanimously embracing the transfer, the Commission and the Member States had divergent preferences and could not agree on updating the formal rules of the EU to reflect the new reality of FDI policy.

Commission preferences

The preferences of the Commission (mostly DG Trade) have been clearly and persistently in favor of regulating and transferring FDI policy to the EU level. Indeed, the Commission had called, unsuccessfully, for a competence shift for more than a decade before it finally happened during the Convention. This was altogether for practical reasons, for reasons of improving EU economic competitiveness, and for reasons of competence extension for itself.

The issue was initially raised during the Intergovernmental Conference that led to the Treaty of Maastricht in 1992 but was quickly abandoned. The issue of including “foreign direct investment” in the Common Commercial Policy was reopened again by the 1996 Commission opinion for the IGC that resulted in the 1997 Treaty of Amsterdam. But that IGC took place in the tense context created by Opinion 1/94 of the European Court of Justice (ECJ), which was tasked with determining who, of the Commission or the Member States, was responsible for negotiating and concluding agreements over trade in the growing field of services (Meunier & Nicolaidis, 1999). The ECJ had in effect sent the ball back to the politicians, and the reform of the Common Commercial Policy to include trade in services was already sufficiently contentious without compounding it with the issue of international investment.

The Commission reintroduced yet again the issue of extending EU competence to investment policy in its opinion for the 2000 IGC that led to the Treaty of Nice. But the political context was not ripe for two main reasons. First, the imminent enlargement of the EU to a dozen more countries, all with disparate and even contradictory interests, lent a sense of urgency to the negotiation over the reform of Article 133, the main article governing trade policy –this was not the time to tackle yet another new issue onto the already busy agenda (Meunier & Nicolaidis, 2011). Second, globalization –mostly in its trade and investment dimensions—had recently become a hot political issue leading to massive mobilizations worldwide. Just two years earlier, the negotiations conducted since 1995 under the auspices of the OECD for the Multilateral Agreement on Investment (MAI), which aimed to ensure that host governments would treat foreign and domestic firms similarly in order to facilitate international investment, had been derailed both for lack of support by the negotiations parties (especially France and the U.S.) and by vigorous public demonstrations organized by a diverse collection of non-state actors (Walter, 2001; Henderson, 1999; Kobrin, 1998). To the very public failure of the MAI succeeded the following year the very public failure to launch the Millennium Round of World Trade Organization (WTO) negotiations in Seattle, where an eclectic collection of anti-globalization activists had again mobilized and protested that “the world is not for sale” (Klein, 1999; Bové & Dufour, 2001). Since the Nice IGC took place in this context, no one at the Commission or the Member States judged that this would be a propitious time to debate over the inclusion of FDI policy under exclusive competence –even if the Treaty extended EU competence to most trade in services, including service-related investment.

After failures at the Maastricht, Amsterdam, and Nice IGCs, the Commission asked again that foreign investment regulation be included under the Common Commercial Policy during the IGC that led

to the Constitutional Treaty. Trade Commissioner Pascal Lamy specifically asked the Convention's Working Group VII on external relations to include the regulation of investment policy (Lamy, 2002).

Member State preferences

Member States did not share at all the Commission's preferences for a competence shift. Yes, the arguments about the costs of cacophony and confusion could be compelling for some, but overall they were dominated by the costs of relinquishing sovereignty. For outbound FDI, the preferences of all the Member States are similar: open external markets for their own investments and obtain maximum protection for these investments. But preferences are more diverse when it comes to inbound FDI, and Member States were not ready to give up their ability to regulate who invests in what on their own territory. Indeed, no Member State was in favor of the competence transfer.

For the many Member States exporting FDI, the worry was great that a supranational regime regulating, and constraining, investments would prompt more restrictions on their own foreign investments.

When it comes to inbound FDI, EU countries are employing a variety of methods which put them in competition with one another, such as national investment promotion agencies, fiscal and infrastructure incentives, and various regulations on FDI screening. The Member States that do benefit from this regulatory competition, especially through laxer screening procedures, have no incentive to push for a more cohesive approach to FDI policy. The Member States that do have stringent screening rules did not want to transfer in practice the authority over inbound investment policy to the EU either, because it might jeopardize their own national security should such a screening mechanism may be forfeited by the majority of Member States. As for the other Member States (such as the Scandinavian countries), they may fear that the transfer of such authority to the EU would create a more restrictive, protectionist investment regime, and therefore oppose such a transfer on liberal grounds. The bottom line is: no Member State supported a transfer of FDI competence to the EU.

Pressure groups preferences

Although FDI decisions are primarily an economic consideration driven by market forces, they are also deeply shaped by the economic, political, and legal rules governing investment in the host country. As a result, pressure groups have fought over the design of these rules, but none was really the instigator of the competence shift.

When the idea of a common EU investment policy started to surface during the 1990s, as annual global flows of FDI had risen from \$60 billion in 1985 to \$315 billion in 1995 throughout the world (Walter, 2001), leading academics argued that it was necessary to regulate FDI (Graham, 1996). So did international business organizations and large multinational corporations, which preferred a more uniform policy framework for investments instead of the highly complex and variegated patchwork of existing national and bilateral rules. As a result, the WTO, the OECD, and other international organizations started to craft and negotiate multilateral investment regulations.

The EU-wide business organization Business Europe (formerly UNICE), as well as other EU-wide business associations such as the European Services Forum supported the EU's handling of investment agreements with a single voice at the time of the Convention, but they were not particularly proactive about it (UNICE, 2003). These same organizations again approached the EU to demand a single EU

investment agreement with China in order to tackle barriers to European FDI in China in 2011 (European Commission, 2011). But even these organizations, which wanted a unified stance for outbound FDI, did not favor a unified stance for inbound FDI. UNICE/Business Europe specifically declared to have “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.” (BusinessEurope, 2008)

Moreover, not all business organizations supported the competence shift. Many national business associations were actually opposed to the shift and let it be known before the signing of the Lisbon Treaty. After the Treaty came into force, the lobbying by European business organizations against the new sweeping powers of the EU over FDI policy, especially the Member States’ ability or lack thereof to negotiate new BITs, intensified, particularly coming from the German Industry Federation (BDI), the United Kingdom’s Confederation of British Industries (CBI), and the French MEDEF (Corporate Europe Observatory, 2010)

As for non-business pressure groups and non-governmental organizations, many pressure groups and non-governmental organizations were opposed to the transfer of the competence over international investment policy to the supranational level –such as environmental groups, labor groups, consumer groups, and intellectuals intent on protecting national culture-- like they did had successfully done for the failed Multilateral Agreement on Investment.

3. FDI, FROM NATIONAL TO SUPRANATIONAL COMPETENCE

The Lisbon Treaty formally transferred FDI competence to the EU. This competence shift seems like a well thought-out response to an outdated, confused, and costly situation --a rationally designed delegation intended to maximize European bargaining power in international investment negotiations and assert the EU as a meaningful external actor. This section tells a different story, however --one where the radical transfer of competence crept its way into the treaty by stealth and serendipity and resulted from Commission actions and Member State inaction.

The inclusion of FDI policy in the Convention

The new EU-wide policy on FDI was not initially planned as the Member States proceeded to launch the “Convention on the Future of Europe”, which was expected to usher in a new European constitution. During the Convention, the Common Commercial Policy had been folded into the busy Working Group VII on the EU’s external action, which also covered the creation of an external action representative, an external action service, defense, foreign aid, development issues, etc. As a result, trade policy received little attention in the deliberations of the working group. There was some limited debate about the existence of mixed competences and qualified majority voting in the field of services, mostly led by Sweden and Finland (Niemann, 2012), as well as about an enhanced role of the European Parliament over trade policy decisions, but the issue of foreign direct investment was not raised, except by Trade Commissioner Pascal Lamy –but to no avail. The final report of the working group, prepared by the Convention’s Secretariat under the presidency of Jean-Luc Dehaene (Belgium), did not include any reference to investment policy (European Convention Secretariat, 2002).

The Praesidium met to discuss the recommendations of the working group on April 22 and 23, 2003 at Val Duchesse. This was a particularly contentious meeting: European politicians and policy-makers were discussing foreign policy barely a month after the start of the U.S.-led intervention in Iraq, which had divided Europe.² After the president of the Praesidium, Valéry Giscard d'Estaing, left the meeting, the discussion continued, chaired by Dehaene, on more technical articles. The two existing articles on the Common Commercial Policy, Art. 131 and 133, had been more or less copied and pasted into the draft constitutional text as Articles 23 and 24 of Part II, Title B. John Bruton, the former Prime Minister of Ireland now representing national parliaments in the Praesidium, suggested that some reference needed to be made in the provision on Objectives to the “removal of obstacles to foreign direct investment” (the rapid economic growth of Ireland, then known as the Celtic Tiger, was being fueled by FDI). This was agreed. Michel Barnier, the then EU Commissioner for Regional Policy who was acting as representative of the EU Commission in the Praesidium, then proposed to make the change operational via the EU competence by also adding “and foreign direct investment” in the provision describing the Common Commercial Policy –which happened without further discussion.

The Praesidium endorsed the text of draft articles at the end of the day. As the French expression goes, this opportunistic four-word add-on went “like a letter in the mail”; it was not even mentioned in the summary of the proceedings (European Convention Secretariat, 2003).

From draft to the final Constitutional Treaty

The next step was the discussion of the draft text prepared by the Praesidium in the full Convention. As expected, the chapter on external action proved to be the most controversial, especially the provisions on the Common Foreign and Security Policy and the External Action Service. The Common Commercial Policy was almost forgotten amidst the deluge of several thousands of amendments that were proposed on the EU's external action. Only 99 amendments were raised concerning the CCP (European Convention, 2003).

Out of these 99 amendments on trade policy, only 32 were about foreign direct investment. These all asked specifically to strike down the inclusion of “foreign direct investment” from the competence of the EU. Some of these amendments argued that foreign direct investment fell under the free circulation of capital, instead of trade policy, and was governed as a result by mixed competences or even by exclusive competence of the Member States. Others asked that FDI be subjected to unanimity voting. Some claimed that “Foreign Direct Investment is an entirely different field from trade policy and its inclusion in the Common Commercial Policy would represent an immense and possibly unintended increase in EU competence” (Voggenhuber, et al., 2003). One amendment explained that even though the intent of the Commission might have been justified, the article needed to be made more precise: “We understand that inclusion of “foreign direct investment” is intended to address a Commission request to be able to conduct negotiations on a multilateral investment treaty in the WTO rather than to remove Member State competence to conduct bilateral investment activity. We would support the intention. However, we see the need to use a more precise term than “foreign direct investment”” (Hain, 2003).

² Personal interview with author, November 2012.

A few amendments commented on the stealthy actions of the secretariat and/or the Commission: one wrote that “there was no such recommendation for the inclusion of foreign direct investment from the working group” (Earl of Stockton, 2003), while another one commented that “The inclusion of a reference to foreign direct investment in the draft is another example of the secretariat taking a unilateral decision to greatly extend the scope of the article, despite there having been no such recommendation from the working group” (Heathcoat-Amory, 2003).

The majority (10) of these anti-FDI amendments came from French politicians, followed by British and German politicians, several of whom were very prominent politicians such as Dominique de Villepin (France’s foreign affairs minister), Joschka Fischer (Germany’s foreign affairs minister), and Peter Hain (a member of the British cabinet who was representing the Blair government at the Convention). In spite of the prominence of its backers, these amendments asking from the exclusion of FDI from EU competence were a drop in the bucket of all the other controversies surrounding the proposed changes to the EU’s capacities for external action.

The sweeping extension of EU competence over foreign investment policy was not much noticed in legal, business, or academic circles either, with very few exceptions, such as the Confederation of British Industries which denounced the Constitution’s excessive centralization of foreign and commercial powers with the EU Commission (Peterson & Ceysens, 2003).

When the IGC approved the draft treaty establishing a Constitution for Europe in June 2004, the two articles (renamed III-216 and III-217) enshrining the inclusion of foreign direct investment under the Common Commercial Policy were left intact (Conference of the Representatives of the Governments of the Member States, 2004).

From the Constitution to the Lisbon Treaty

After the Constitutional Treaty failed to be ratified as a result of its popular rejection through referenda in France and the Netherlands in 2005, the Member States reworked the constitution in what came to be known as the Treaty of Lisbon, which they signed in December 2007 and which came into force two years later. The Irish presidency did not want to reopen substantive issues during the IGC that followed the failure of the constitution. Following the guiding principle of the non-reopening of the substance, trade policy was not reopened, in spite of the raising of some Member State objections against the inclusion of FDI during the IGC. In the end, the paragraphs in the articles extending the scope of trade policy to foreign direct investment and subjecting it now to exclusive Community competence (now renamed Art. 206 and 207) made it intact into the new treaty from the version hastily conceived in the Praesidium (Council of the European Union, 2009).

The simple three word addition of “foreign direct investment” in the Lisbon Treaty changed the complex, multi-layered situation governing FDI in Europe and radically reformed, *de jure*, the competences over foreign direct investment policy. According to Article 207 TFEU, “The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union’s external action.” Therefore, foreign direct investment is now

exclusively part of the Common Commercial Policy: in principle, it is up to the Commission to negotiate BITs, to protect EU outbound FDI abroad, and presumably to regulate inbound FDI on behalf of the Member States.

Explaining the competence shift

Why did the competence shift happen? It was certainly not the result of intergovernmental bargaining since the outcome ran counter to the preferences of all Member States. Neither was it the result of pressures from business group, who were divided on the issue and not proactive in any way. The competence shift was more the result of a combination of serendipity, stealth, and prioritization than of straight Commission entrepreneurship.

The competence shift first and foremost resulted from smart agency by the Commission. FDI made its way into the draft Treaty through serendipitous circumstances. If not for the last minute inclusion of “foreign direct investment” in the draft article on the Common Commercial Policy through the prompt action of Commission representatives, FDI probably would not have become an exclusive competence of the EU until at least the following treaty revision, since it had not been included in the draft produced by the working group.

Stealth being the key here, the Commission did not broadcast the proposed shift. However, some politicians noticed the stealth inclusion of the competence shift in the final draft and tried to derail it. Why did they fail? First, they could not derail the competence shift for procedural reasons. As all amendments, the ones on FDI mentioned earlier were discussed by the Praesidium, which was mindful that it was the Praesidium itself that had made the modification, that it was justified on the basis of the evolution of the world economy, and that the arguments against the shift were not convincing.³ In the remainder of the Convention, FDI was no longer raised, so the Praesidium found that there was a consensus on it.⁴ Subsequently, the Lisbon Treaty was adopted without reopening the non-controversial areas of the Constitution, so that is how FDI was formally transferred to the EU.

Second, Member States did not derail the FDI competence shift because, even though there was no support for it, fighting the shift was not a political priority either amidst an extremely busy agenda. This was a question of prioritization. At the Praesidium, the chapter on external relations produced thousands of amendments, in particular on CFSP (this was the time of the Iraq war). Member States had to pick their battles. While there was effectively a discussion on trade, no Member State delegate prioritized an amendment on FDI to discuss in the second round of amendments.⁵ In isolation, the Member States would have fought the competence shift, but given the time and resource constraints they had to devote to the complex Constitution, they chose to fight more important issues.

³Personal interview with author, November 2012.

⁴ There are unfortunately no minutes of the Praesidium.

⁵ Personal interview with author, November 2012.

4. A PROTRACTED POLITICAL BATTLE IN THE IMPLEMENTATION PHASE?

Did the consequences under which the competence over FDI was transferred have implications on the implementation of the new policy? During the transition period, the Commission has produced a variety of documents to clarify and map the future of European investment policy (European Commission, 2010; European Commission, 2010). But Member State support for these efforts has been minimal for the moment, reinforcing the argument made in this paper that the transfer to exclusive supranational competence happened with little debate. This makes implementation difficult as there has been no political appetite from the Member States to surrender sovereignty and move investment policy up to the supranational level in practice, especially in the current climate of suspicion and disillusionment regarding European integration. This section explores the real political debate that starts now, in the implementation phase, yet constrained by the framework that Member States reluctantly or inadvertently agreed to in the Treaty.

Confusion over the definition of Foreign Direct Investment

The Lisbon Treaty did not define “foreign direct investment”. According to the standard definition accepted by policymakers and academics, direct investment is a class of investment where the investor acquires at least 10% of the voting power of an enterprise, which establishes ‘lasting interest’ and control over the affiliated company’s operations – in contrast to portfolio investment where investors do not generally expect to influence the management of the enterprise (Organization for Economic Cooperation and Development, 2008; International Monetary Fund, 1993). The EU Commission had indicated in 2002 in its “Concept paper on the definition of investment”, a communication by the Commission to the WTO working group on the relationship between trade and investment, that it shared that definition (European Community, 2002). Therefore, the broad policy understanding is that the new exclusive competence does not apply to portfolio investment, over which Member States presumably retain competence. Indeed, the majority of legal scholars concur that the Treaty does not extend EU competence to portfolio investment (Herrmann, 2010; Bungenberg, et al., 2011).

Nevertheless, because of the vagueness of the wording in the Lisbon Treaty and especially because of the fact that most international investment agreements do not distinguish between direct and portfolio investment, this will certainly be open to interpretation (Herrmann, 2010). As legal scholar Julien Chaisse recently wrote, “it is safe to conclude that the EU now holds exclusive competence over FDI, which is interpreted to include the classical standards of investment protection. However, the absence of definition of “FDI” in the Treaty still leaves scope for disagreement. In fact, one can be sure that those Member States which are unhappy with the competence transfer and intend to retain their existing BITs will ask the CJEU to clarify this issue” (Chaisse, 2012, p. 9).

Disputed competences over the negotiation of international investment treaties

Confusion reigned initially over the validity of existing Bilateral Investment Treaties, the competence to conclude exiting negotiations, and the competence to negotiate new treaties. Some international arbitration lawyers started noticing in 2008 the implications of the reform: Member States would no longer be allowed to enter into new BITs, but what does this mean for existing BITs? This is the area where most political capital has been expended so far by Member States.

This initial confusion, evidence that this major reform had taken place mostly “under the radar” of the Member States, is best illustrated by the following anecdote. On December 1, 2009, Germany had organized a major conference on Bilateral Investment Treaties to celebrate the “Golden Jubilee” anniversary of its BIT with Pakistan, which was the first BIT signed in the world in November 1959.⁶ At this occasion, Germany was supposed to sign a new BIT with Pakistan. This conference had been planned for a long time and included speakers such as Prime Minister of Pakistan Syed Yousaf Raza Gilani, many German politicians, and a large assortment of European academics, practicing lawyers, and business people. Shortly before the conference, one of the German negotiators suddenly realized that the reform of FDI introduced in the Lisbon Treaty had potentially transferred the competence over BITs. He asked the Commission if Germany was still competent to sign its own BIT with Pakistan and was told that, no, the competence had indeed been transferred on 1 December, the date of entry into force of the Lisbon treaty (also the start date for the conference!); however, that Treaty (in article 2(1) TFEU) did offer the possibility to transfer back competence to the Member States and to grandfather national BITs, and the Commission intended to use that possibility.⁷ In the end, the BIT was ratified in 2011 by the German Parliament and then sent to the European Commission for final approval.

The most immediate effort expended by the Commission in order to transform the vague inclusion of foreign direct investment in the Lisbon Treaty into a coherent, implementable policy has focused on outbound investment and notably the status of Bilateral Investment Treaties. This focus is understandable since the EU is a net outward investor, especially in emerging economies, and its Member States have more than 1,200 agreements with extra-EU countries.

The Commission has been very pragmatic so far in interpreting and implementing the new EU policy sketched by the Lisbon Treaty, especially in the face of opposition, if not “denial”, by Member States.⁸ It has acknowledged that the EU will not be able to negotiate international agreements to replace the plethora of existing Member State BITs because its material and personnel resources are limited, even if its long-term goal is for EU BITs to replace national BITs. The new regulation dealing with extra-EU BITs came into force in January 2013 (European Commission, 2012). It “grandfathers” existing treaties by confirming their validity until the EU decides to replace them. It also allows Member States to open talks with third countries with whom the EU has not concluded a BIT, though such talks will need to be supervised and approved by the Commission (European Commission, 2012). Instead, the Commission will concentrate on a few agreements that it deems crucial for the EU as a whole, such as with Canada, India and Singapore. Pragmatically, it lets Member States negotiate BITs with the “small fish”, while it takes care of negotiation with the “big fish”.

One potential problem, however, may be whether third countries agree with that transfer of competences. They may refuse to recognize this new competence and cling to their old agreements, especially the BITs with a “sunset clause” making them still valid several decades after their termination. What is in it for them? They may refuse to recognize the new EU authority because of the EU’s lack of

⁶ “Fifty Years of Bilateral Investment Treaties Conference 2009: Taking Stock of the Future”, 1-3 December 2009, Frankfurt am Mein, Germany, <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&StdntWrtnGmptnEn=True&language=50YearsBITCnfPrg>.

⁷ Personal interview with author, November 2012.

⁸ Personal interview with author, November 2012.

competence in portfolio investment. What would be the incentive to switch to an EU investment treaty if it does not cover all aspects of the existing BITs individually concluded by Member States in the past? They may also refuse to renegotiate existing agreements to take into account the new supranational competence because of the reciprocal demands that a EU with more bargaining leverage may make on them. How to get third countries on board is not an issue that has been the topic of much political debate among the Member States.

A looming political battle over inbound FDI

Nobody, neither in the Member States nor at the Commission, gave much thought to the policies governing inward investment⁹, even though with a stock of \$7.5 trillion the EU is the world's largest recipient of FDI (OECD, 2013). Yet the inclusion of foreign direct investment under the purview of the Common Commercial Policy leaves many questions unanswered about inward FDI. Investment promotion, like trade promotion, is one area that the EU is probably leaving to Member States. But what about the vetting of particular investment deals? Right now each country has its own national procedures (or has none), whether based on national security or on economic criteria. Theoretically, under current practice, a foreign investor can be turned down by one Member State on grounds of national security and then invest in another one instead --and as a result have its goods or services circulate throughout the Single Market, including in the country from which it was initially barred. Today, only ten Member States have restrictions in place to screen foreign investment in defense-related sectors, and only Lithuania has an outright prohibition on FDI in defense and security from non-EU and non-NATO members (Fiott, 2012). Has the vetting of inward investment become an exclusive competence of the EU?

Implementation will be very difficult when it comes to inbound investment because there are so many divisions among the Member States, between the Member States and EU institutions, and within the EU institutions. So far no proposal on inbound investment has been followed through with actual legislation.

The strongest supporter so far of a common approach to inbound investment has been the European Parliament, which now has a bigger say on trade policy as a result of the Lisbon Treaty. In part because of the challenges and growing fears triggered by the surge of Chinese FDI into Europe, the European Parliament formally asked the Commission and the Member States in 2012 "to set up a body entrusted with the ex ante evaluation of foreign strategic investment, along the lines of the Committee on Foreign Investment in the United States (CFIUS), in order to obtain a clear picture of businesses operating and investing in the territory of the EU" (European Parliament, 2012, p. 25).

The Commission has so far been divided regarding the necessity of establishing a common vetting system for foreign investment into the EU. In February 2011, the EU Commissioners for Industry and Entrepreneurship, Antonio Tajani, and the Internal Market, Michel Barnier, wrote a joint letter to Commission President José Manuel Barroso on foreign investment. They warned against Europe's naivete and recommended specifically the development of a supranational body to vet FDI in the EU, analogous to the CFIUS system in place in the United States to make sure that non-EU investments in

⁹ Personal interview with Kimberly Hopewell, January 2013; Personal interview with author, November 2012.

Europe are not for real “attempts to close down businesses after having stolen all of their “know-how” (European Commission, 2011). The majority of Commission officials, however, dismissed this proposal, on the grounds that this would be interpreted as a protectionist move, could alienate Chinese investments in Europe, and have repercussions on European investment in China. The EU should remain open to all foreign investment in order to “lead by example”. Leading the charge against a European version of CFIUS, European Trade Commissioner Karel De Gucht cautioned against a “neither desirable nor feasible” screening system for investment at the EU level, recalling the multiple benefits of foreign investment (increased productivity, increased trade, access to capital, etc.) and reminding his fellow Europeans of the reality: “we need the money” (De Gucht, 2012). Such a system, he argues, would also national security considerations to be used “...as a false pretense to justify the protection of vested economic interests.”

As for the Member States, no one for now is openly supporting this proposal. The Member States that do benefit from their lax national standards and regulatory competition (mostly in Central, Eastern, and Southern Europe) have no incentive to push for a more cohesive approach to inbound FDI policy. The Member States that do have screening rules (such as France, Germany, the Netherlands) do not want to transfer in practice the authority over inbound investment policy to the EU either, because it might jeopardize their own national security should such a screening mechanism may be forfeited by the majority of Member States. As for the other Member States (such as the Scandinavian countries), they may fear that the transfer of such authority to the EU would create a more restrictive, protectionist investment regime, and therefore oppose such a transfer on liberal grounds.

5. CONCLUSION

By tracing the process through which the EU acquired a radical and exclusive competence over FDI policy, this paper provided a case-study of political development and competence creep in action. It showed that the competence shift over one of the most important areas of the global economy happened under the radar, in spite of opposition from all the Member States. However, it did not happen through treachery by the Commission, but rather through a combination of serendipity and prioritization among a busy, complex agenda.

The EU is still a hybrid and ambiguous international actor when it comes to FDI policy, and it will remain so for a while, this article predicts, notwithstanding the radical delegation of competence enshrined in the Lisbon Treaty. Does the formal competence shift matter if Member States do not support implementation? Formally, the competence to make policy affecting both outbound and inbound foreign direct investment and to negotiate international investment agreements belongs exclusively to the EU. In practice, however, the scope of the EU’s authority has so far been limited by the lack of Member State support resulting from individual preferences formed over fifty years of negotiating investment terms on a national basis.

Because of the absence of political debate prior to the competence shift, confusion still reigns and Member States are not willing to let go of their sovereignty that easily. Therefore, it would not be improbable for the issue to ultimately escalate to the European Court of Justice (ECJ), should a controversial case arise.

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