Who's afraid of foreign investment screening?
The rise of investment screening mechanisms in advanced economies

Lorenzo Bencivelli
Violaine Faubert
Florian Le Gallo
Pauline Négrin[1]

May 9, 2025

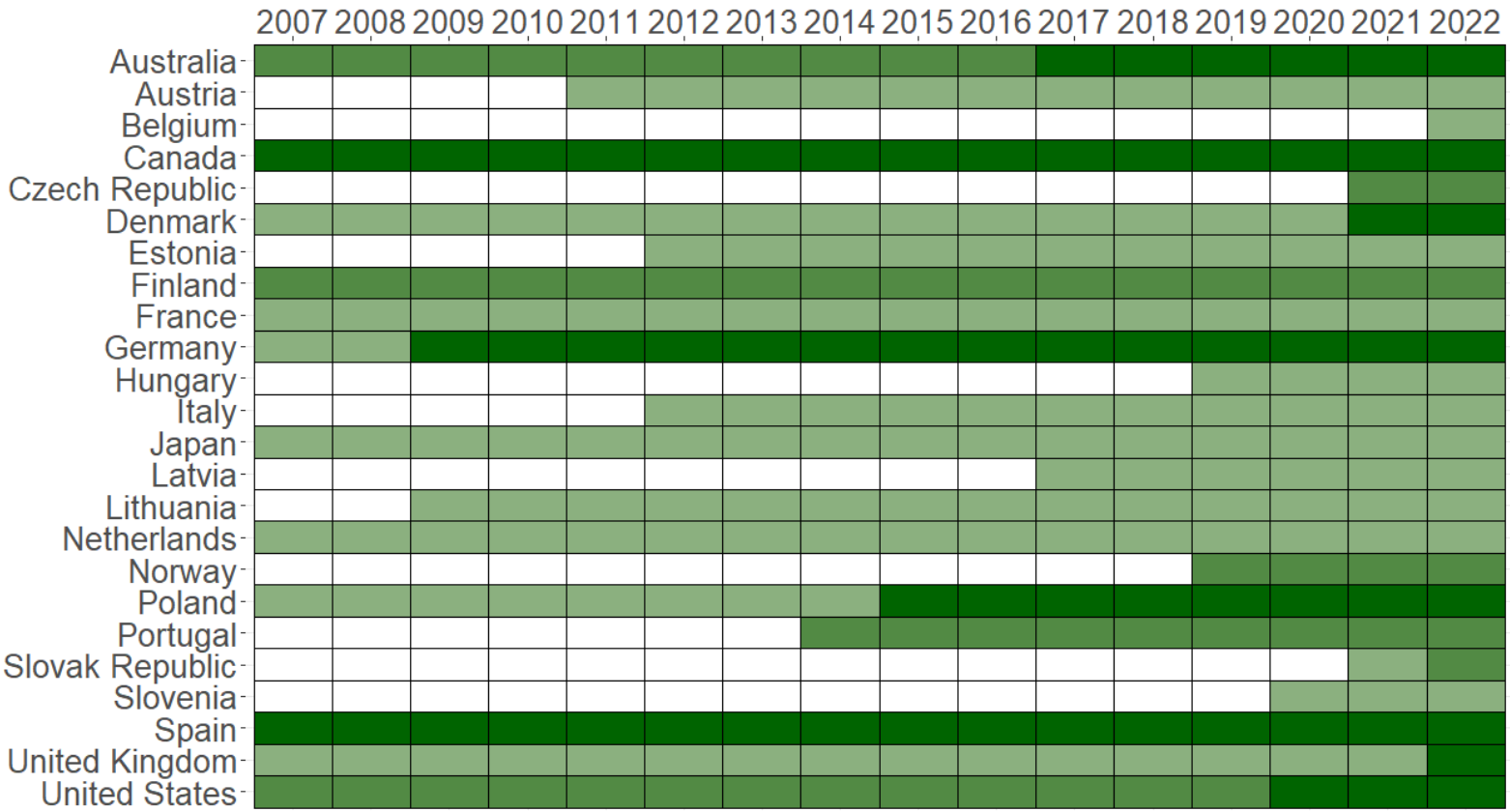
[1] The views expressed are those of the authors and do not necessarily reflect those of the Banque de France or the Banca d'Italia.

Outline

1. Introduction
2. Comparing ISMs
3. Challenges in assessing the impact of ISMs
4. ISM enforcement
5. Conclusions
6. Appendix

Introduction: the rise of ISMs

ISM: a law or regulation which empowers national authorities to assess, authorise, condition, prohibit or unwind transaction on grounds of national security or public order.

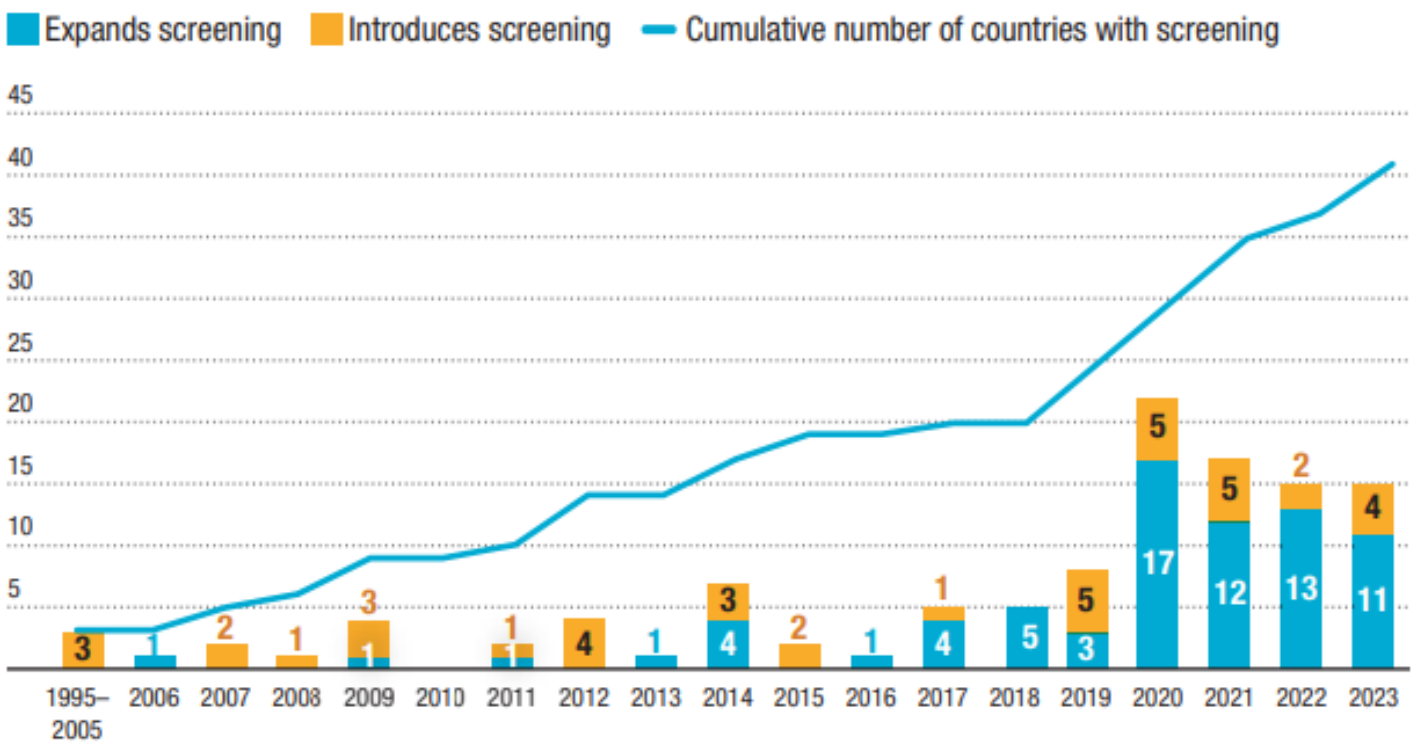


Note: white - countries that did not have an ISM ; light green - countries who have sectoral mechanisms (where the government has the authority to review a list of sectors); green - countries with cross-sectoral mechanism (government can review investments in any sector); dark green - mixed mechanism (specific list of sectors to stricter review requirements). Source: PRISM database.

Introduction: geo-economic fragmentation

Screening regimes continue to expand

Countries introducing or expanding security-related investment screening
(Number)



Source: UNCTAD, Investment Policy Monitor database, accessed 31 March 2024.

Research questions

The traditional paradigm of openness (the more the better) is in review and countries need to balance between free trade and national security ▸ Def.

- **Impact on transactions** (extra sunk cost?)
- Impact on **capital allocation**?
- Implications for the EU and impact of the EU regulation:
  - How this extra layer combines with the existing regulation?
  - Is there some cross-country heterogeneity left within the EU?
- **Contributions:**
  - a database on national screening laws in advanced economies;
  - a synthetic index suitable for cross-country comparison;
  - a database on the outcome of screening decisions.

Historical perspective and literature review

- The literature has focused on benefits of incoming FDI: innovation, competitiveness, job creation, etc. (Alfaro et al. 2004, Javorcik 2004, Stiebale 2016)
- Scarce (but growing) literature on macroeconomic effect of ISMs:
  - Studies in international economics (Binici 2010, Albori 2021, Eichenauer 2022) using OECD Regulatory Restrictiveness Index (RRI).
  - In International Political Economy, seminal work by **S. Meunier and S. Bauerle Danzman** (2021) on ISMs patterns and determinants (Politics and Regulation of Investment Screening Mechanisms - PRISM), followed by new studies (Chan Meunier 2022).
  - Eichnauer and Wang (2024), McCalman, Puzzello and Walter (2022 onward)

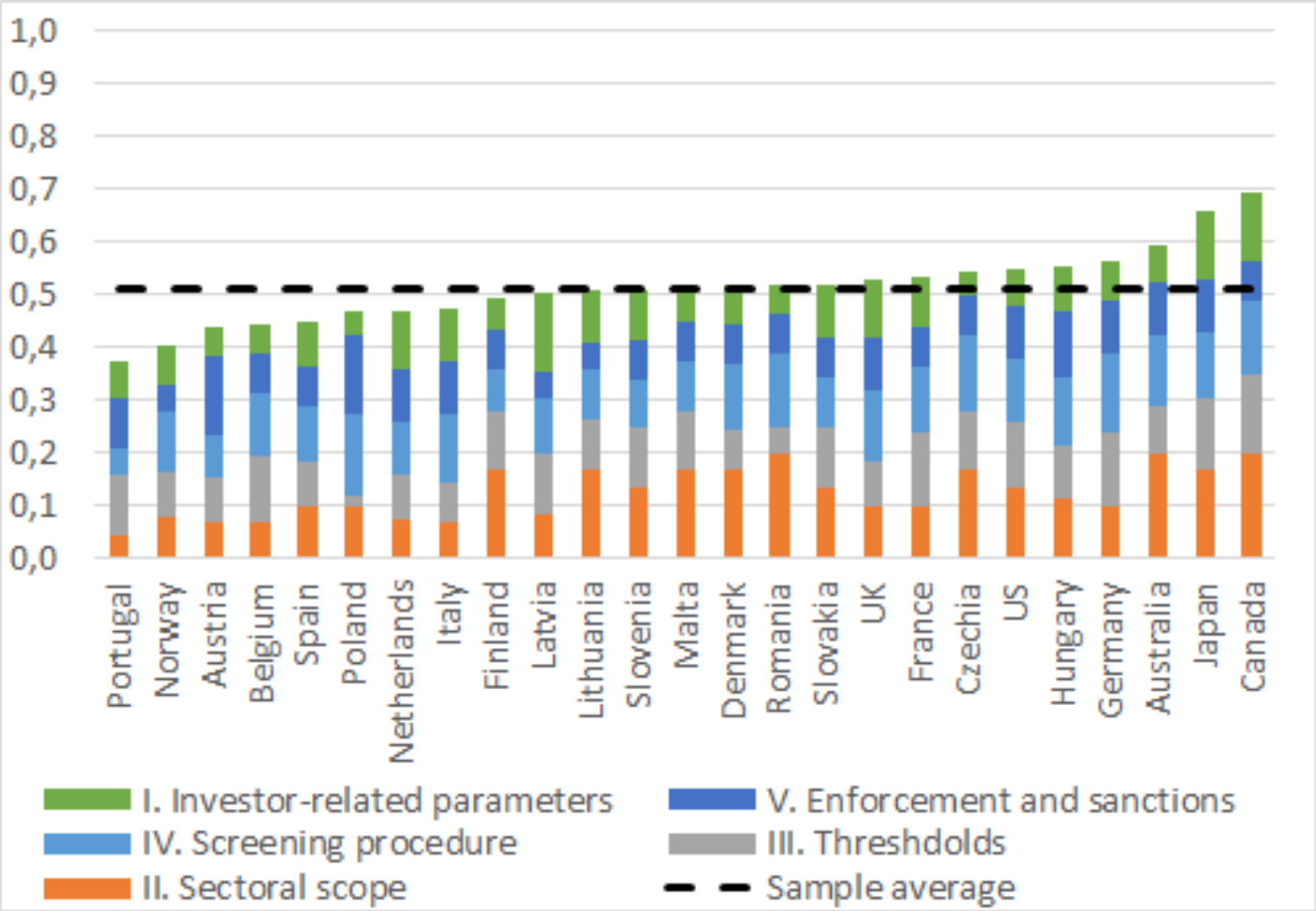
Comparing ISMs - one index to rule them all

We propose a **synthetic index [0-1] to gauge the restrictiveness of ISMs**.

- **Advanced economies**: EU, US, UK, NO, CA, AU, JP.
- Legislation in force in the first half of **2023**.
- **5 dimensions**:
  - **Investor-related parameters** and territorial scope;
  - **Sectoral scope** and coverage of **greenfield** investments;
  - **Thresholds** (monetary/shareholding) triggering a review;
  - **Screening procedure** (ex-ante vs ex-post, mandatory vs voluntary notification, investigation powers of the authorities, length of the review process...);
  - **Enforcement** (mitigation measures, sanctions...).

▸ Caveats

Comparing ISMs - results



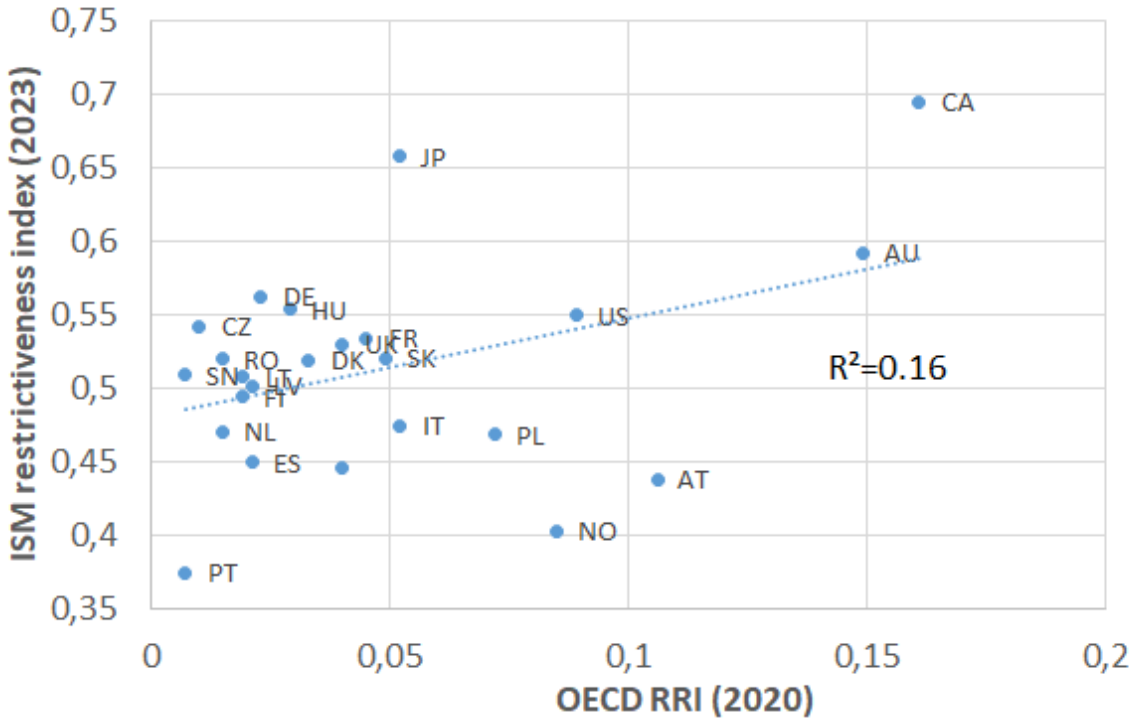
The index ranges from 0 (relatively less restrictive ISM) to 1 (relatively restrictive ISM). Each dimension consists of several items, the scores of which are averaged to obtain the dimension score.

Comparing ISMs - heterogeneity in Europe

Dark (light) blue: relatively more (less) restrictive ISM. Green: legislative process expected to result in the adoption of a new mechanism. ▸ The case for a regional ISM

The ISM index complements existing indicators

- Low correlation with existing measures of FDI restrictiveness



The ISM restrictiveness index and the RRI range from 0 (relatively open regime) to 1 (relatively restrictive). The OECD's FDI Regulatory Restrictiveness Index (RRI) measures statutory restrictions on FDI. Measures taken for reasons of public order and essential security interests are not scored. By contrast, the ISM restrictiveness index focuses on investment screening on grounds of national security or public order.

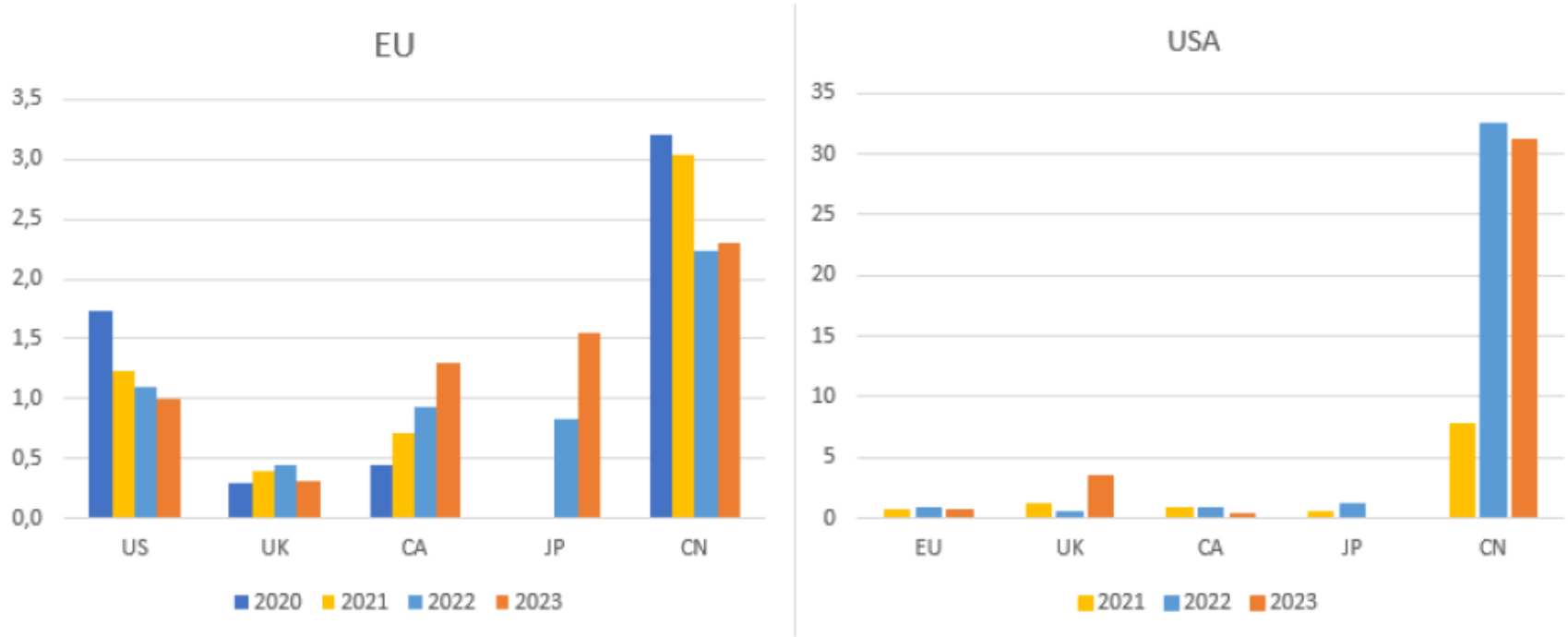
Impact of ISMs on investment decisions

Challenges in assessing the impact of ISMs on investment decisions

- **Possible effect on transactions**: self selection, deterrence and other unobservable effects
- **Impact on attractiveness**:
  - Countries with weak institutions may feel compelled to protect more its national interests
  - Less attractive countries may be willing to weaken its national interest framework

How proportional is the enforcement?

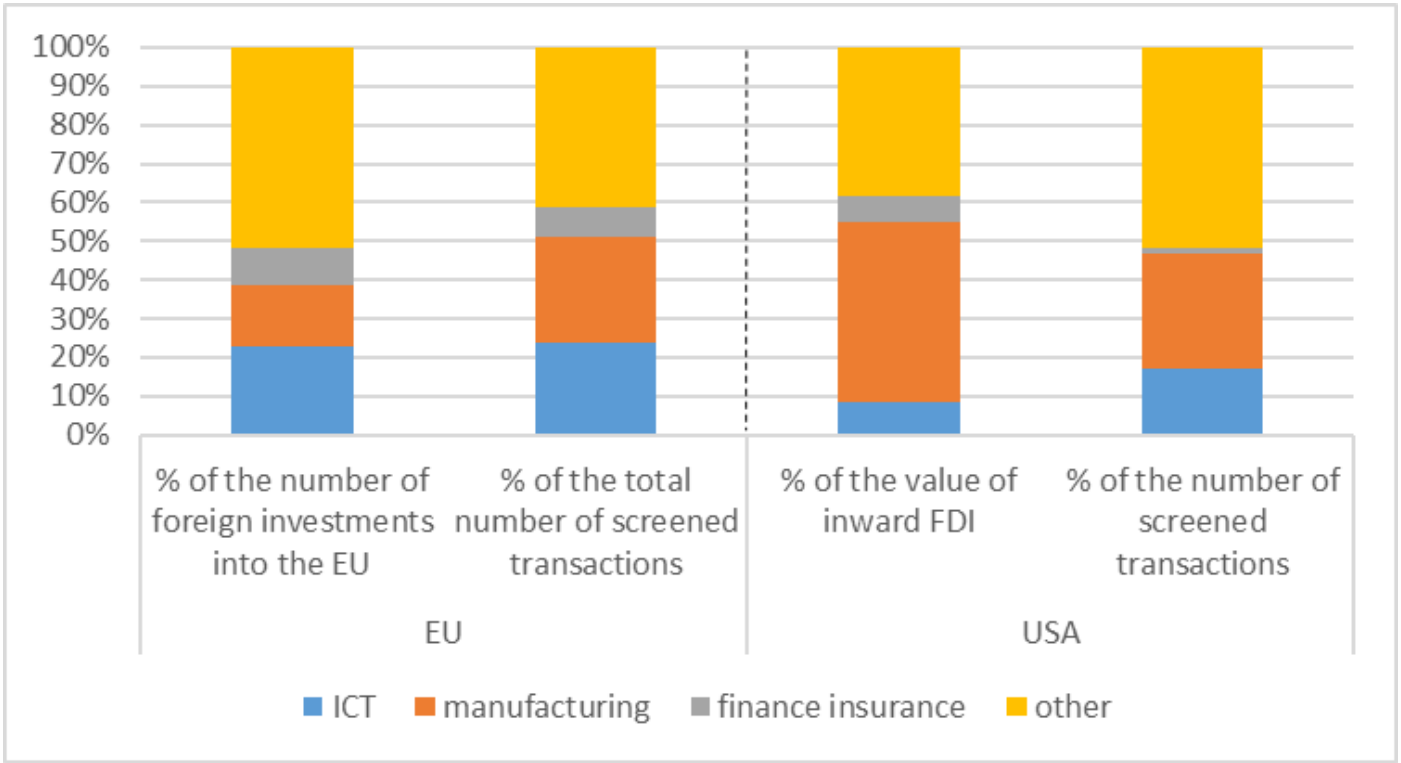
Operations from China are disproportionately screened compared to its share of investments, particularly in the US



Source: Europan Commission, CFIUS, BEA, authors' calculations. A ratio above 1 means an over control compared to relative share in M&A (UE) or inward FDI flows (US).

ISM enforcement - sectoral targets

Manufacturing is disproportionately screened in both the EU and the US



Source: national reports, OECD, authors' calculations.

Conclusions

Contributions:

- An index measuring the restrictiveness of national ISMs suitable for measuring cross country differences and regulatory convergence;
- Restrictive ISMs can coexist alongside an otherwise liberal investment environment;
- Tentative assessment of the impact of ISMs on transactions.

Future related developments: actions set out in the "European Economic Security Strategy" (June 2023):

- "review the Foreign Direct Investment Screening Regulation";
- "examine what security risks can result from outbound investments and on this basis propose an initiative by the end of the year".

Thanks for your attention

National security - basic concepts

National security refers to the protection and preservation of a nation's sovereignty, territorial integrity, and the well-being of its citizens against external and internal threats.

Key (mostly interrelated) aspects of national security include:

- Defense and military security
- Economic security (ensuring a stable economy, protecting critical infrastructure, industries, and resources, and safeguarding the country from economic espionage or foreign manipulation)
- Cybersecurity
- Energy and resources
- Political security
- Public safety

back

Annex: Enlarged notion of national security

- Enlarged notion of national security, beyond the defense industry
- e.g. EU Regulation shows that the scope of most FDI regimes encompasses transactions relating to:
  - **critical infrastructure** (energy, transport, water, communications, data processing/storage, electoral or financial infrastructure);
  - **critical technologies and dual use items** (AI, robotics, semiconductors, cybersecurity, quantum computing ...);
  - supply of **critical inputs**, including energy or raw materials, as well as food security;
  - access to **sensitive information**;
  - the freedom and pluralism of the **media**
- other factors that may be taken into consideration in determining whether a FDI is likely to affect security or public order: foreign investor **controlled by the government of a third country**

back

Caveats

- Screening criteria do not systematically determine ex-ante the restrictiveness of national ISMs
  - The identification of potentially threatening transactions relies on the **interplay of criteria and parameters** (Pohl and Rosselot, 2020):
  - We analyse thoroughly the main features of ISMs (exemptions and modulating criteria)
- The restrictiveness of screening regimes can vary greatly depending on **how rules are implemented**
  - **Actual enforcement** of national investment screening regimes and degree of **transparency/discretion** of national authorities in granting approvals **not factored in**
  - **Robustness check:** does the ISM synthetic index, which maps restrictiveness ex-ante based on national legislation, correlate with the

back

Annex: Comparing ISMs - scoring rules

- The highest score for any dimension is capped at 1 (full restrictions on FDI on national security grounds) and the lowest is 0 (no restrictions on foreign investments)
- Scores are scaled down when restrictions only apply to a subset of investors or transactions
- Each dimension consists of several items, the scores of which are averaged to obtain the dimension score
- In some cases, scores range from 0 to 1 and reflect the empirical distribution of the sample
- For most items, the score is either: 1 (full restrictions); 0.5 (restrictions apply to a subset of transactions or investors); 0 (absence of restrictions).

II.C	**Coverage of greenfield investments**	
	Yes	1
	Yes above a certain monetary threshold	0.5
	No	0

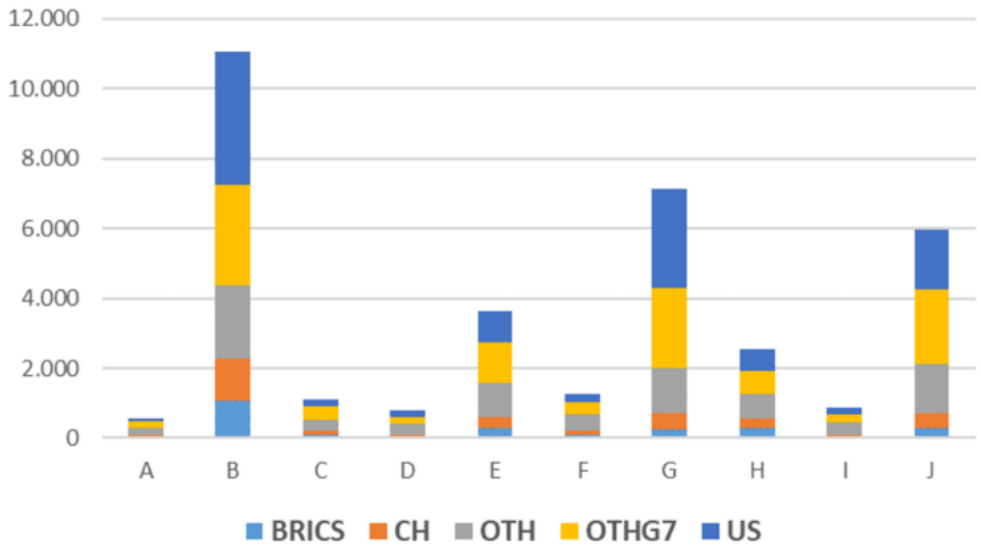
The case for a regional ISM

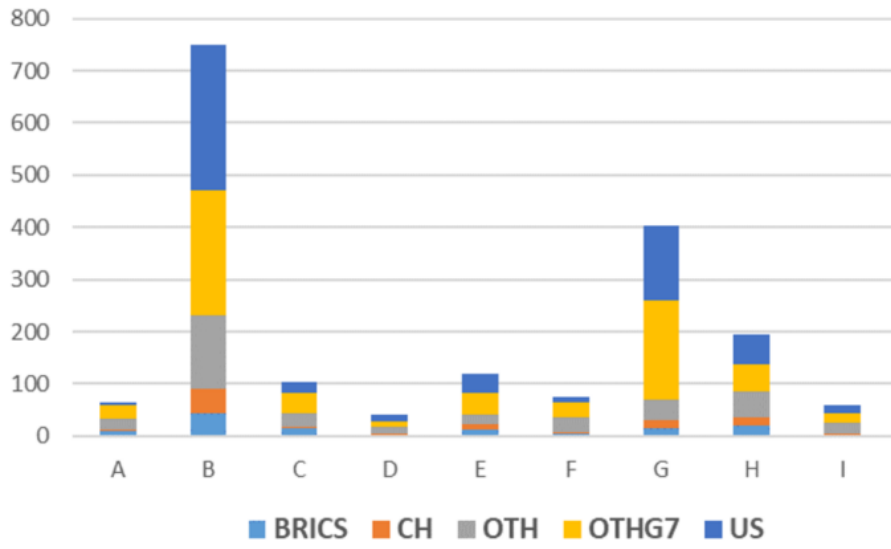
- **The EU case: the first regional mechanism**
  - It is not an instrument protecting the single market, rather a tool for EU OSA
  - Regulation 2019/452 encourage country members to adopt ISM and mandates exchange of information
  - Multidimensional and cross-country scope
  - New stricter regulation under discussion
- **EU enforcement practices**:
  - Very few blocked transactions (1%) but more screened transactions in 2022 (55% against 29% in 2021), largely authorised without conditions (86% in 2022).
  - 90% of notifications from 6 countries (AT, DK, FR, DE, IT, ES).

Back

ISM enforcement - sectoral targets

Distribution of M&As into the EU by sector of destination (left: number of deals; right: aggregate deal value billion euro)

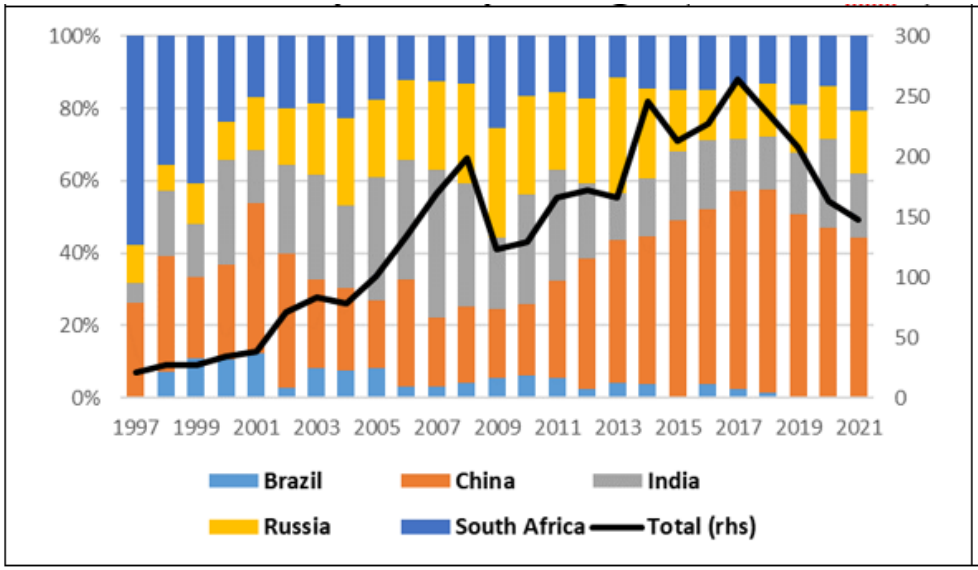


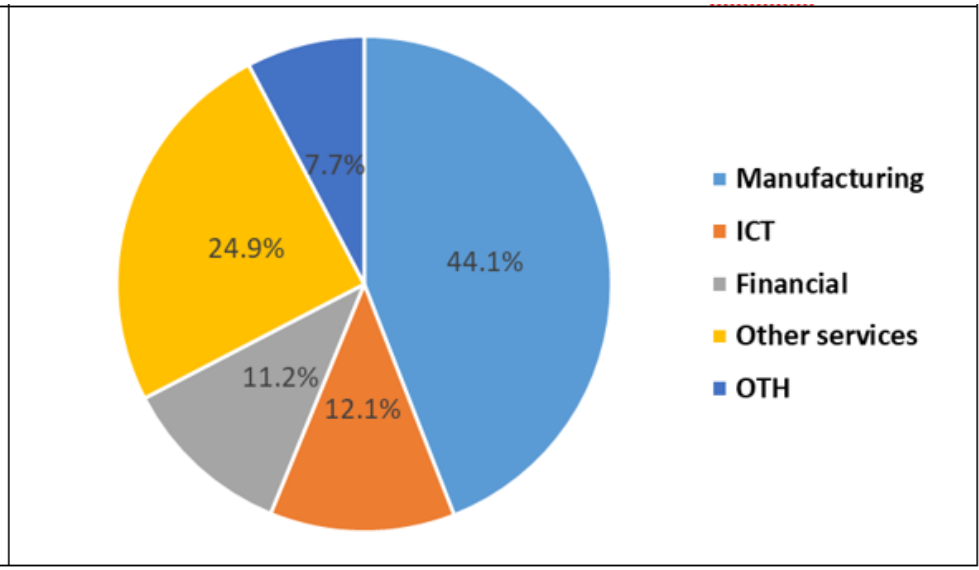


Note: A: agriculture, mining; B: manufacturing; C: energy, utilities; D: construction; E:wholesale and retail trade; F: transport; G: ICT; H: financial services; I: real estate; J: other services.
Source: BvD (1998-2022), authors' calculations.

ISM enforcement - investments from BRICS

Investments (M&A) from BRICS





Source: BvD, authors' calculations.

- BRICS became large investors in the EU with China's driving the dynamics;
- ISMs as a response to this trend, consistent with enforcement practices.
- Manufacturing receives a large amount of operations from BRICS.