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Balancing security and economics: domestic state-firm relations and investment screening mechanisms in Europe

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ABSTRACT

In an era of intense geopolitical competition, concerns about the impact of foreign investments in strategic sectors of the European economy have led policymakers to review European investment screening mechanisms (ISMs). In doing so, European institutions and member states have to find a balance between security and economics, maintaining a favorable environment for potential investors while simultaneously protecting specific sectors that they deem important for European and national security. We argue that the existing structure of state-firm relations decisively shapes the institutional configuration of European ISMs at the national level. We identify two ideal-typical patterns of state-firm relations: Public governance and private governance ecosystems. We hypothesize that variations in domestic state-firm relations decisively shape the institutional configurations of European ISMs, and, more broadly, how European governments and firms navigate the trade-off between openness and protection of strategic assets.

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Introduction

In an era of intense geopolitical competition, concerns about the impact of strategic foreign investment on the European economy have led policymakers to rethink their foreign direct investment (FDI) regulations. Especially after 2016, European countries became increasingly concerned about excessive Chinese influence over their strategic assets, as well as about an unbalanced and non-reciprocal FDI playing field between the EU and China (Chan & Meunier, 2022). As a result, EU policymakers called for the strengthening of national investment screening mechanisms (ISMs) and launched a major initiative to coordinate investment screening
policies at the European level. In doing so, European institutions and member states have to find a balance between security and economics, maintaining a favorable environment for potential investors while simultaneously protecting specific sectors that they deem important for European and national security (Bauerle Danzman & Meunier, 2023; Jensen & Malesky, 2018). Nevertheless, Europe remains more open to FDI than other parts of the world (even those that are traditionally considered to be very open, such as the United States), but, precisely because of this, it is potentially more exposed to foreign influence in strategic sectors.

In February 2017, the economy ministers of France, Germany and Italy sent a letter to European Trade Commissioner Cecilia Malmström to start discussions on FDI screening at the European level (BMWK, 2017). In March 2019, the European Parliament and the Council adopted the Regulation (EU) 2019/452, establishing a framework for cooperation on incoming FDI. This framework sets out basic standards for investment screening and creates a network for information sharing across the EU. Information sharing takes place mainly between member states—who remain responsible for the screening process—and between member states and the European Commission on those transactions that relate to EU-wide critical technologies and infrastructures. Most EU member states have either adopted new ISMs, amended an existing mechanism, or initiated a legislative process expected to result in the adoption of a new mechanism or amendments to an existing one. At the intra-European level, we observe the bargain that needs to be struck between incentives to attract foreign investors and the need to protect certain strategic assets. So, how do European countries navigate the trade-off between openness to FDI and national security?

The academic literature has not provided a satisfactory answer to this question. In our view, there are two main problems: first, the literature has not systematically sought to explain cross-country differences in ISMs. While there are works on ISMs protectionist or liberalizing effects (Baltz, 2017; Dimitropolous, 2020; Schill, 2019; Vlasiuk Nibe, 2023), and on how they are shaped by the rise of Chinese investments, the ‘geopoliticization’ of trade policy and the backlash against globalization (see Babić & Dixon, 2022; Bauerle Danzman & Meunier, 2022; Chan & Meunier, 2022; Chilton et al., 2020; Vlasiuk Nibe et al., 2023), no analyses have examined how each country makes the delicate assessment required in the trade-off between investment maximization and national security. The scholarly literature has thus far not provided a theory to explain cross-country differences in ISMs. Protectionism, different national interests, the rise of Chinese investments and the geopoliticization of trade policy are all part of the story, but they do not explain the different institutional configurations of ISMs. Second, most of the literature on investment screening has historically focused primarily on established frameworks, such as the Committee on Foreign Investment in the United States (CFIUS), rather than on screening mechanisms in the EU, even though some of these have been in place for a considerable period of time and almost all EU members states have now joined the ranks (Baltz, 2017; Kang, 1997).

We aim to fill these two gaps. Our argument is that the existing structure of state-firm relations decisively shapes the institutional configuration of domestic ISMs. Drawing on the varieties of capitalism (VoC) literature and state-business interactions, we identify two fundamental properties that shape state-firm relations: (1) the degree of state protection and ownership of strategic firms, and (2) the
degree of interpenetration between public and private sector elite networks. Based on the combination of these mutually reinforcing properties, we derive two ideal-typical patterns of state-firm relations: public governance and private governance ecosystems. We hypothesize that variations in domestic state-firm relations decisively shape the institutional configurations of ISMs, and, more broadly, how European governments and firms navigate the trade-off between openness to FDI and protection of strategic assets. We test our theory first through a most likely case-study comparison of two countries with different governance ecosystems: France and the Netherlands. We then provide a comparison of all ISMs in the EU as a plausibility check on how the distinction between governance ecosystems holds beyond the two in-depth cases.

Our contribution to the existing literature is threefold. First, our theoretical framework provides an explanation for cross-country variation in ISMs. This framework succeeds in isolating structural features of domestic state-firm relations that are of primary importance for understanding FDI regulations, as well as government and firm preferences for openness to FDI and protection of strategic assets. Our theory contributes to the debate on state-industry relations in comparative political economy and can also be generalized to better conceptualize state-firm relations in strategic sectors that have an economic and national security component.

Second, we provide a useful starting point for systematically comparing the institutional configurations of ISMs. We offer an original conceptualization and operationalization of the dependent variable that isolates the legal, organizational, and procedural aspects of ISMs. This helps advance the embryonic literature on investment screening, complementing recent data-collection and data-generation efforts in this field (Bauerle Danzman & Meunier, 2023). In doing so, we fill an empirical gap as there are few studies comparing the specific institutional properties of European ISMs.

Finally, our paper contributes to the debates taking place in the field of international political economy (IPE), e.g. those on economic statecraft and how economic resources are used for strategic purposes (Farrell et al., 2021; Thurbon & Weiss, 2021), on public-private relations in activating economic statecraft (Calcara, 2022; Chen & Evers, 2023; Gjesvik, 2023; Mastanduno, 1998), on how different sectors are increasingly isolated for export control and investment screening measures (Malkin & He, 2023), and on the role of Europe in this context (De Ville, 2023; Gehrke, 2022; Lavery, 2023).

The paper is structured as follows. First, we present our conceptualization and operationalization of the dependent variable, in order to identify different types of ISMs. Second, we focus on the distinction between public and private governance ecosystems and derive empirically testable hypotheses on the configuration of ISMs. The empirical analysis tests these hypotheses by examining ISMs in both public (France) and private (the Netherlands) governance ecosystems, and through an analysis of all other ISMs in the EU. The conclusions discuss the research findings and their implications.

The institutional configuration of ISMs

A key aspect of FDI regulations is how countries balance openness to FDI (through FDI attraction agencies, tax incentives, a favorable regulatory environment) with
the protection of certain sectors deemed important for national security. ISMs are an empirical manifestation of these balancing efforts, and they vary considerably across countries.

By definition, screening on the basis of national security assesses ‘the security implication of foreign investment, and functions to mitigate risks as they arise and block transactions that present unresolvable risks’ (Bauerle Danzman, 2021, p. 260). Over the years, the concept of national security has expanded to include critical infrastructure, personal data, and a growing list of dual-use technologies, as well as energy security, health security, and/or social security. The EU defines ISMs as instruments of general application, such as law or regulation, and accompanying administrative requirements, implementing rules or guidelines, setting out the terms, conditions and procedures to assess, investigate, authorize, condition, prohibit or unwind FDIs on grounds of security or public order (EU Regulation, 2019/452, Art. 2(4)). For the sake of conceptual clarity, this paper focuses exclusively on routinized legal procedures of investment screening on the basis of predetermined criteria. Ad hoc prohibitions of certain investments and, in particular, ad hoc review systems also function as tools to limit incoming FDI, but this is not done through a routinized legal process.

We identify two ideal types of ISMs, one open and one closed. Three characteristics determine whether an ISM is closed or open: (a) the scope of the ISM, (b) the review authority or committee, and (c) the level of formal investor protection built into the screening mechanism. We conceptualize open ISMs as those mechanisms that cover many investments and give the government a high level of discretion to scrutinize incoming investments. They are characterized by a broad scope, a broad screening committee and low levels of formal foreign investor protection. Closed ISMs, on the other hand, set relatively clear limits on the types of investments that are subject to government review. They are characterized by a narrow scope, a narrow screening committee and a higher level of formal protection for foreign investors. Admittedly, these are two ‘ideal’ ISMs, and ‘real’ ISMs will lie somewhere in the middle between these two extremes. For this reason, we empirically code an ISM as open or closed if it contains at least two out of the three constitutive characteristics.

This conceptualization is analytically useful for two purposes. First, this dichotomous variable helps us to isolate the legal, organizational and procedural aspects of ISMs that are co-constitutive and mutually reinforcing. In what follows, we will look in more detail at the three characteristics that make each ISM more open or more closed in its configuration. Second, the distinction between open and closed ISMs provides us with coordinates for comparing different types of ISMs.

**The scope of review**

The scope concerns the breadth of the economy that is covered by an ISM. The coverage of an ISM therefore determines the legal scope for governmental review and intervention. Most analyses distinguish between sectoral, cross-sectoral, mixed- and asset-based reviews (Bauerle Danzman & Meunier, 2023; Dimitropoulos, 2020; Wehrlé & Pohl, 2016). Sectoral review means that there is a list of sectors over which the government has review authority. Cross-sectoral review means that the government can screen in any sector. In the case of an asset-based
review, the government can review acquisitions of specific assets, such as specific companies, infrastructure assets, or patents. Mixed-based reviews allow governments to review on a sectoral basis and review some sectors more strictly than others.

For analytical convenience, we conceptualize the scope of ISMs as a dichotomous variable that can be either broad or specific. If a government reviews many sectors, or has a cross-sectoral review system, we classify the ISM as broad in scope. Operationally, the cut-off point at which we consider that an ISM covers many sectors is twenty sectoral groups or more, based on the variable ‘total sectors’ in the PRISM dataset (Bauerle Danzman & Meunier, 2023). Typically, the screening in these cases goes beyond what are traditionally considered to be security-sensitive sectors. We consider the scope to be ‘specific’ when the review is sectoral, mixed or asset-based and covers a relatively low—less than twenty—number of sectoral groups. We consider investment thresholds for ISMs with a specific scope to be higher than for ISMs with a broad scope, because a specific scope reduces the incidence of active government intervention in cross-border investments. An open ISM will thus have a broad scope because it allows more government intervention, while closed ISMs have a narrow scope that limit government discretion for intervention.

Review authority

The competent authorities in charge of carrying out reviews and the number of actors involved in the screening process also vary across ISMs. The executive is usually in charge of investment screening (Dimitropoulos, 2020). Yet, the committees and departments that screen and decide whether to reject, mitigate, or accept an investment are composed of representatives from different branches of the executive. These can be drawn from the ministries of defense, foreign affairs, economic and commercial affairs, interior affairs, the justice department, the finance department, the health department, the ministry for environmental affairs, intelligence services, the police, to name a few.

It is not uncommon for several government authorities to be formally involved in the screening process. The number of institutional actors involved is important because the more actors are involved, the more potential exists for veto players who may have an interest in blocking a particular investment, and the more actors who can influence the screening process. Narrow authorities have a limited number of formally involved actors in the screening process, empirically a maximum of two actors. A broad committee consists of more actors involved in the screening process, widening the pool of actors that may have an interest in intervening in cross-border transactions, and in turn increasing the occurrence of government intervention.

The number of actors involved in the process may also affect the outcomes of the ISM, as the more actors involved, the more likely it is that the ‘national interest’ will overshadow economic and domestic firm-level interests. Broad committees are more likely to interpret the national interest more broadly by taking into account a wider range of security concerns and are less likely to take into account economic concerns to attract FDI. A narrow committee with a small number of actors represented is more likely to prioritize economic concerns in the vein of
investor protection and FDI attraction. An open ISM will therefore have broad committees, while a closed ISM will have narrow committees.

**Formal investor protection**

The legislation establishing the screening mechanism draws the boundaries of government intervention in FDI, and defines the formal\(^1\) legal protections available to foreign investors. Different types of ISMs affect the formal protections and legal certainty for foreign investors in sectors covered by the ISM.

First, the possibility for investors to easily appeal a screening decision makes it more difficult for governments to indiscriminately restrict investment and provides investors with some certainty that they will be able to remedy an unfavorable screening decision.\(^2\) The accessibility to judicial review benefits investors, and keeps governments on their toes. Second, ex-post review, meaning review after the completion of an investment, gives the government a lot of potential leeway in its screening and diminishes legal certainty for investors because they are not assured that their investment will not be subject to ex-post review. Similarly, formal call-in power allows governments to ‘call in’ transactions that are officially not subject to screening, widening potential government discretion. Third, the timeframe of the review process, and the extent to which governments can meet deadlines impacts the extent to which a government can intervene. Some ISMs will automatically approve an investment if the government fails to meet its deadlines, while others do not unless the investor has received an explicit green light from the government. An open ISM is characterized by relatively difficult appeal procedures, ex-post reviews, call-in power, and long and not very stringent review timeframes,\(^3\) while a closed ISM will have an easier appeal process, no or limited ex-post review, no call-in power, and short\(^4\) and stringent review deadlines Table 1.

**Public and private governance ecosystems**

To explain the variation in the institutional configurations of ISMs, we propose a theoretical framework drawing on the comparative political economy literature. Research on VoC has highlighted the different institutional ways in which firms coordinate with each other and with other economic and political actors (Hall & Soskice, 2001). Subsequent research has focused on the role of the state in shaping economic and industrial policy (Schmidt, 2009; Schwartz & Tranøy, 2019), and on how some countries shape their economic and political systems to attract FDI (Baccaro et al., 2022; Nölke et al., 2015; Nölke & Vliegenthart, 2009). The literature on VoC has rightly placed emphasis on how institutional arrangements and continuous interactions between states and firms generate institutional complementarities through increasing returns and lock-in through feedback (Blyth & Schwartz, 2022). However, this literature on formal institutional arrangements needs to be contextualized here in areas that lie at the heart of national security, such as the control of investments in strategic sectors. In this regard, the literature on state-business relations has focused on state-to-firms interactions and informal networks of coordination and interpenetration between public and private actors (Clift & Woll, 2012; Larsen & Ellersgaard, 2017; Weiss, 2021). In strategic areas, formal and informal
mechanisms of interaction between states and firms often complement each other. Informal ways of interacting can fill gaps in the possibility of developing formalized relations between states and industries, between the public and private sectors.

Drawing on comparative political economy, we identify two ideal types of governance ecosystems: private and public governance ecosystems. These two ideal types are characterized by two fundamental properties of state-firm relations:

- The degree of state protection and ownership of strategic firms (formal protection through ownership).
- The degree of interpenetration between public and private elite networks (informal coordination through ‘revolving doors’).

Ideal typically we thus, on the one hand, identify public governance ecosystems characterized by a high degree of formal protection and state ownership of strategic firms, through golden shares or state involvement in corporate shareholdings, i.e. by controlling a fixed share of the company, acting as an equity investor or through cross-capital participation. Additionally, it is characterized by close informal channels of interaction between government and businesses, often oiled by educational and professional homogeneity (Clift & McDaniel, 2021). Close relations and social proximity between public and private actors may also facilitate the so-called ‘revolving door’ phenomenon, i.e. the flow of people from the public to the private sector and vice-versa (Belli & Bursens, 2021; Seabrooke & Tsingou, 2021).

On the other hand, private ecosystems are characterized by limited direct and formal intervention in the activities of its strategic firms and rely on competition and market principles to organize the governance of strategic sectors (Calcara & Marchetti, 2021; Weiss, 2021). Elite networks here are highly fragmented, and intersectoral career path mobility is almost non-existent. This fragmentation is due to the fact that formal competition regimes preclude collusion among elites and to the fact that the lack of intersectoral career mobility results in early career decisions channeling individuals into sector-specific elite networks (DeVore & Weiss, 2014, pp. 506–507).

The typological distinction serves the analytical purpose of identifying ‘ideal types’, ‘one-sided accentuations’ to be used in the construction of the research hypotheses, without seeking to account for all empirical varieties on the ground
(Hay, 2020). Our identification of two ideal types therefore does not prevent empirical cases from moving from one to the other or from falling somewhere between public and private governance. Drawing on the literature of comparative political economy, we posit that the two properties that characterize different ecosystems are co-dependent and mutually-reinforcing. Complementarities exist, indeed, where features of institutional structures reinforce each other by mutually generating increasing returns. In public governance ecosystems, the high degree of state protection of strategic industries favors a high degree of interpenetration between public and private elite networks, and vice-versa. Conversely, in private governance ecosystems, low levels of protection of strategic industries and formal competition regimes hinder the emergence of close informal public and private elite networks Table 2.

The identification of two ideal types of governance ecosystems allows to generate two broad expectations of how different governance ecosystems tend to organize their ISMs. In public governance ecosystems, we expect that policymakers prefer an open ISM, resulting in a broad scope of investment control because tight connections between state and business means that governments have to ensure that problematic actors do not enter into that emmeshed firm-government network. This results in an open ISM that leaves more room for the government to intervene when it sees fit, resulting in a lower level of institutional protection for investors. In this type of governance ecosystem, firms rely on their governments to provide them with informal cues and guidance on what is in or out of bounds. Because of their informal relationship with the government, firms are not concerned about excessive government intervention and discretion in screening FDI, and therefore do not organize to limit government control. Rather, they prefer to strengthen their informal ties with the government in order to secure their privileged relationship. The outcome, i.e. the ISM’s institutional configuration, is an ISM with a broad scope, with a broad review committee and relatively little investor protection.

**H1a**: In public governance ecosystems, we expect a high degree of government discretion in FDI screening. Specifically, we expect governments to prefer open ISMs with a broad scope so as to leverage their privileged formal and informal relationships with strategic firms. For the same reasons, we also expect the government to prefer a lower level of protection for foreign investors and the competent review authority to be composed of several actors from different branches of the executive.

**H1b**: In public governance ecosystems, we expect firms to capitalize on their privileged relationship with the government and not to resist broad screening mechanisms.

<table>
<thead>
<tr>
<th>The degree of protection by the government</th>
<th>Public governance</th>
<th>Private governance</th>
</tr>
</thead>
</table>
| High                                      | High degree of ownership  
Government plays a management role | Low  
• Low degree of ownership  
• Government plays a shareholder role |

<table>
<thead>
<tr>
<th>The degree of interpenetration between public and private elite networks</th>
<th>Public governance</th>
<th>Private governance</th>
</tr>
</thead>
</table>
| High  
• Strong formal and informal networks between government and firms  
• Revolving doors | Low  
• Distant – little government role in internal workings of firms and vice versa  
• Limited revolving doors |
In private governance ecosystems, by contrast, state-firm relations are characterized by market relations and enforceable formal contracts. In such contexts, the state provides a detailed legal framework within which firms operate (Hall & Soskice, 2001, p. 18; Weiss, 2021). In the absence of the close informal relationships that characterize public governance ecosystems, governments do not have the same baseline vulnerability to potentially harmful investors gaining access to government networks through cross-border acquisitions. States therefore have less need to protect as many domestic firms from takeovers, as these transactions would provide less of a foothold in business-government networks. We therefore expect the legal scope for investment control to be more specific than in public governance ecosystems and expect the government to prefer to set formal legal standards in ISMs. In the absence of informal state-industry networks, combined with their need for access to international finance, firms prefer to have a clear picture of the opportunities and constraints of their domestic investment regime. As a result, they are likely to organize themselves to limit government control over FDI inflows, and to prefer a narrow scope of government intervention in cross-border transactions. Given the preferences of these two actors, we expect an ISM that is specific in scope, with a narrow review authority and a high degree of investor protection.

H2a: In private governance systems, we expect closed ISMs with lower or low levels of institutionalized control over FDI screening. Specifically, we expect governments to prefer a specific scope of the ISM, higher level of protection for foreign investors and a narrow review authority which is likely to be less security oriented.

H2b: In private governance systems, we expect firms to lobby for closed ISMs that are specific in scope, limit government discretion in FDI screening, ensure legal certainty, and provide a high level of investor protection Table 3.

Methodology and case selection

The first part of our empirical analysis tests these hypotheses by comparing the ISMs in France and the Netherlands. To make our distinction, we rely on the VoC and state-business scholarship and purposefully select cases to maximize variation on the independent variable. France can be considered a case of a public governance ecosystem, given its degree of protection and state ownership of strategic firms (Calcara & Marchetti, 2021; Clift & McDaniel, 2021; Schmidt, 2009), and strong informal state-industry relations (Ansaloni & Smith, 2018; Clift & McDaniel, 2021; Jabko & Massoc, 2012; Vauchez & France, 2021). Recent analyses have confirmed a strong interpenetration between the French public and private sectors (Ansaloni & Smith, 2018; Clift & McDaniel, 2021). The Netherlands can be considered as a private governance ecosystem. According to scholarly works, the
Netherlands moved away from state-oriented patterns of state-industry relations to more market-oriented patterns since the 1980s, especially after the privatization of strategic firms (de Jong et al., 2010; Haffner & Berden, 1998; Heemskerk, 2007; Sluyterman, 2010, 2015; Thiemann & Lepoutre, 2017; Touwen, 2014). Recent analysis confirms this distinction, with France closer to the ideal type of public governance ecosystem and the Netherlands closer to a private governance ecosystem (Calcara, 2022).

We base our empirical analysis on primary and secondary sources, on legal and financial reports, as well as on statements from prominent business associations. We pay particular attention to within-case temporal variations to understand the evolution of the national ISM and the preferences of governments and firms. The empirical analysis is structured into three sections. First, we analyze the French and Dutch case. Next, we use the PRISM database and newly gathered data to conduct an analysis of European ISMs to provide a plausibility check on how our theory holds across the EU.

France

In the case of France, a public governance ecosystem, we expect firms to take advantage of their privileged relations with the government, and the government to promote a predominantly broad scope of the ISM. With regard to the review authority, we expect a broad review authority with numerous veto actors that can intervene in specific sectors. Lastly, we expect ex-post screening with long and non-stringent timeframes.

Background

The regime for the control of foreign investment is formally part of the French Monetary and Financial Code (MFC) and provides for the ex-ante control of FDI in sectors of the economy that are relevant to public order, public security, or defense interests. The institutionalization of the review mechanism, now enshrined in articles L 151-1 to L 151-4 and articles R 151-1 to R 153-12 of the MFC, was strongly influenced by the judgment of the Court of Justice of the European Union (CJEU) in the ‘Église de Scientology’ case. In 2000, the CJEU found that the scope of the investment review mechanism in France was so discretionary and the definition of significant investment so broad that it violated the principle of legal certainty and EU Treaty rules on the free movement of capital (Dimitropolous, 2020, p. 101). Over the following decades, France gradually updated its ISM by adding sectors and lowering the thresholds subject to review. The government revised its ISM in 2005, also in response to a rumored takeover of the French dairy company Danone by PepsiCo (Lenihan, 2018). The ISM was subsequently revised in 2014 with the so-called ‘Montebourg Decree’ (Décret 2014-479, 2014), named after the Ayrault government’s Economy Minister. The decree extended the scope of review to the energy, water, telecommunications and public health sectors (Décret 2014-479, 2014). Critically, the decree also mentioned the transport sector and was widely interpreted as an ad hoc political move to block or at least curtail US General Electric’s proposed $16.9
billion bid to buy France’s leading railway company, Alstom.\textsuperscript{10} The decree was explicitly framed by French policymakers themselves as a way to protect national champions from foreign takeovers or, as Minister Montebourg himself emphatically stated in an interview with Le Monde, as ‘the end of laissez-faire’ (Revault d’Allones & Pietralunga, 2014).

The French ISM was reformed again in 2019 through the ‘Loi portant Plan d’Action pour la Croissance et la Transformation des Entreprises’ (PACTE) law, which further expanded the scope of the mechanism to include research and development (R&D) activities in cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, as well as sensitive data (Ministère de l’Economie des Finances et de la Souveraineté Industrielle et Numérique, 2019). In addition, the PACTE law further lowered the ownership threshold from 33.3% of voting rights and capital to 25%. Interestingly, despite the government’s willingness to include an amendment in the PACTE law to restrict Huawei’s access to 5G, protests from senators and French telecom giants such as Orange, Bouygues and SFR, who were concerned about their intra-industry links with Chinese telecoms, led the government to draft a separate and ad-hoc law on 5G (Calcara, 2022, p. 9).

Another amendment in 2020 extended the French investment regime to biotechnologies. These recent reforms of the French ISM give the government a lot of discretion when it comes to intervention in cross-border transactions. This could act as a deterrent to any initiative that might be hostile to the political mood of the government in power. Recently, for example, the words of the French Ministry of Economy in defense of ‘food sovereignty’ led the Canadian retailer Couche-Tard to abandon its attempt to buy the leading French retailer Carrefour (Vidalon, 2021). A similar dynamic of deterrence unfolded when the Chinese car manufacturer FAW’s tried to buy the Franco-Italian car manufacturer Iveco (Fainsilber, 2021). In both cases, it was not even necessary to open a formal investigation.

\textbf{The 2019 French PACTE law screening mechanism}

The French ISM is very broad in scope with a broad review authority. As the law does not define the concept of ‘national interest,’ the French ministry has a high degree of discretion in rejecting, mitigating or accepting foreign investments.

There are three strategic sectors identified by the law and covered by Article R.151-3 of the MFC: a) national security and defense; 2) critical infrastructures, including energy, water, transport, digital communication, food safety, information and press, public health; and 3) R&D in critical or dual-use goods and technologies (Article R.151-3, paragraph II-III of the Monetary and Financial Code). Three cumulative conditions trigger the French ISM: a) acquisition of control of an entity governed by French law\textsuperscript{11}; b) foreign investment in all or part of the business activity of an entity governed by French law; and c) foreign investment to acquire voting shares exceeding, directly or indirectly, the threshold of 25% for the standard procedure or –if the FDI takes place after 31 December 2020–10% according to the temporary regime now in place. Indeed, the PACTE law has further lowered the trigger for ownership threshold from 33.3% of voting rights and capital to 25%. In 2020, the government promulgated a temporary regime, which lowers the trigger threshold for the FDI review mechanism to 10% of foreign shareholding, down
from 25%, for FDI in listed companies. The ISM regulation makes an explicit distinction between European investors and non-European investors, and the third condition only applies to non-European investors. The law also distinguishes between notification requirements and prior authorization requirements. FDI in non-sensitive sectors is only subject to a ‘simple’ notification, while FDI in sensitive sectors requires prior authorization from the Ministry (Charrière-Bournazel, 2014).

The decision to reject, mitigate or accept an investment is taken by the Ministry of the Economy. Specifically, the dossier is examined by the General Directorate of the Treasury with the assistance of the competent officials of the Inter-ministerial Committee on Foreign Investment. The review committee involves officials from different administrative and ministerial departments with specific expertise in the sectors under review. Major defense companies are also regularly consulted by the MoD on foreign investment in dual-use components or in sectors that are part of the military supply chain. The recent decision to prevent the American company Teledyne from acquiring the French company ‘Photonis’ is paradigmatic of the veto power of institutionalized players in certain sectors. After receiving the notification from Teledyne/Photonis, the Ministry of the Economy imposed two conditions: a) the participation of 10% of the French state investment fund Bpifrance, with veto power at the shareholders’ meeting; b) the involvement of an internal security committee, including the French Ministry of the Armed Forces and of the Economy and Finance, with veto power over possible technology transfer to other companies outside France. After long negotiations, the American group accepted the government’s ultimatum. However, the French government, through its Minister of Defense, made a last-minute U-turn, concluding that Photonis’s activities were too strategic to be managed by a non-French player, regardless of any commitments (Xueref-Pviac, 2021). In addition, when a French merger control notification is required (under merger control rules), the Ministry has the possibility to intervene and reject, mitigate or accept a notified transaction on national interests grounds, even if the Competition Authority authorized it. This effectively creates a ‘double veto mechanism’ (Giner Asins, 2021). Multiple actors can therefore participate and eventually intervene on screening decision in their fields of competence, making the composition of the review committee very broad—in line with our theoretical expectations.

In France, there is no ex-post review of investments, not least because anyone wishing to invest in a French company in the broad array of strategic sectors must acquire prior approval from the government to conclude the transaction. The notification itself must be made in French, but should also include a European notification form to be completed in English. Under the 2019 reform, if the Ministry of the Economy’s decision is negative, the foreign investor must stop the transaction and restore the status quo ante at its own expense within a maximum of 12 months from receipt of the notification (Article L 151-3 III MFC; Article R 153-11 MFC). Additionally, the absence of a response from the Ministry within the specified timeframes does not constitute tacit authorization (Giner Asins, 2021). The Ministry’s negative decision can be appealed to the administrative judge. In this case, the foreign investor must prove that the ministry made a substantial error in its assessment. This is a very vague criterion and difficult for companies to prove. Coupled with the usual reluctance of administrative courts to go against the administration, this tends to give the ministry the upper hand in administrative disputes,
which in turn makes foreign investors very reluctant to challenge the government’s
decision (Philippe, 2022). Overall, given the discretionary power of the government
to block investments and the difficulties for investors to appeal to the administrative
courts, the level of protection for foreign investors in the French case is relatively low.

Discussion

In line with our expectations, we found that the French ISM is broad in nature.
Looking at the long-term evolution of the French ISM, we can see that the gov-
ernment has gradually widened the range of sectors covered by the review, while
still retaining a large degree of discretion on how to intervene. The broad config-
uration of the ISMs has been balanced by the continuous formal and informal
relations between the government and strategic firms. Indeed, the latter have con-
sistently supported government intervention to widen the scope of the ISM (Drif,
2018). Large companies preferred a rather broad review, where they can take
advantage of their privileged relationship with the government and oppose too
strict mechanisms or too specific rules. The case of 5G, where France adopted ad
hoc legislation to explicitly block Chinese companies, has indeed disappointed large
French telecom companies which would have preferred more coordination with the
government (Calcara, 2022).

However, not all French companies supported the government’s plan to simulta-
nceously increase the number of sectors to be screened without providing specific
details on how and when these rules would be applied. During the Loi PACTE
negotiations, while large companies sided with the government, new technology
companies and investment funds complained about the lack of detail on the scope
of the new law and the lack of specifics on how to intervene in very large, and
poorly defined, technology sectors, such as artificial intelligence (Normand,
2020). Unlike large companies, French start-ups are heavily dependent on American
investment funds and are more concerned that broad ISMs could discourage for-
eign investment (Rolland, 2018). Our expectations were thus confirmed: the gov-
ernment expanded the scope of FDI, without clarifying in detail when and how it
would review FDI, with the support of strategic French firms who believe they can
use their privileged informal networks to find common ground with the govern-
ment on FDI reviews. However, those who are excluded from this network, like
small or start-up companies, were concerned about the negative impact that the
broad scope of the French ISM could have on their ability to attract FDI.

The Netherlands

In the case of the Netherlands, a private governance ecosystem, we expect a closed ISM.
We expect firms to mobilize to limit government discretion, specifically by lobbying for
scope-limits, high levels of legal certainty and a limited review committee.

Background

Until recently, investment screening in the Netherlands was not institutionalized as
a general, overarching screening mechanism. Investment and ownership restrictions
were codified within separate sector specific laws applicable to the energy industry (Gas Act & Electricity Act), and the telecommunications sector (Telecommunications Act) of which the latter was recently sharpened (September 2020) in response to the controversy that surrounded the implementation of 5G by the Chinese company Huawei (Rijksoverheid, 2020; van den Berg & Immerzeel, 2022).

In the past, for non-covered sectors, the Dutch government relied on existing legislation, state ownership, and voting rights secured in independent business foundations to intervene ad hoc whenever political opposition arose regarding acquisitions involving companies of national interest. The Dutch government, for example, intervened through capital injections in the merger/acquisition of the Dutch bank ABN AMRO in the aftermath of the financial crisis. The attempted acquisition by the Mexican firm América Móvil of KPN (2013) was foiled through the KPN foundation using the so-called ‘poison pill’ approach, a strategy in which a foundation exercises a call-option to buy preferential shares allowing the firm to protect itself against hostile takeovers. On another occasion the government invested €20 million in the Eindhoven-based Dutch computer chip company SMART Photonics in 2020 to avoid a potential foreign take-over (Olsthoorn, 2020). These cases show the capital intensive and ad hoc nature of previous (in)direct interventions by the Dutch government when it came to the prevention of specific investments.

Despite these interventions, the Dutch government resisted calls to systematically screen incoming investment. In 2008 the idea of an American-style screening mechanism in the context of the growing activity of Sovereign Wealth Funds (SWFs) was tabled on the basis that it would disincentivize FDI and because it was believed existing legislation would provide sufficient protection (Tweede Kamer der Staten-Generaal, 2008). After the thwarted takeover of KPN in 2013, a working group was established to investigate potential gaps in the Dutch screening legislation. The creation of an ISM was raised again, but met a silent death (Nationaal Coördinator Terrorismebestrijding en Veiligheid, 2014). Vocal opposition from businesses against ISMs often contributed to the failure to advance this type of legislation despite cases that instigated some political animus to do so (de Boer & Elemans, 2023).

Following the EU regulation on investment screening in 2019 and the Covid 19 pandemic, the conditions were ripe for a renewed and ultimately successful attempt to create an ISM (de Boer & Elemans, 2023; Tweede Kamer der Staten-Generaal, 2019a, 2019b). In September 2020, the Dutch government circulated the first draft of a legislative proposal. Following a consultation period and bicameral scrutiny, the law ‘Veiligheidstoets investeringen, fusies en overnames’ (Vifo) officially entered into force on 1 June 2023. The pre-existing sector-specific laws remained in place, and the Vifo law extends government scrutiny to provide a safety net to efficiently capture those investments previously not covered (Tweede Kamer der Staten-Generaal, 2019a). To professionalize the screening process, the ‘Bureau Toetsing Investeringen’ (BTI) was established within the Ministry of Economic Affairs and Climate (MEZK) to handle the screening of investments that fall within the scope of not only the Vifo law, but also all other sectoral screening laws (Roscam Abbing et al., 2023).

**Law Vifo 2022**

The Wet Vifo is sectoral and applies to enterprises that provide a vital/critical service or that produce sensitive technologies. Vital service providers include
sectors such as transport of district heating, nuclear energy, air transportation, port areas, infrastructure for financial markets, banking, and renewable energy (Art. 7). The law singles out specific entities such as Schiphol Airport, the port of Rotterdam, and Groningenveld (a gas and wind-energy park), as well as enterprises that hold specific licenses in the sectors outlined in the legislation (MEZK, 2023). New categories can be added to the list of screened sectors and entities if necessary by government decree (Art. 7 (11)). When it comes to sensitive technologies, the proposal includes dual-use technologies and military equipment, and again reserves the right for the government to add new sectors through governmental decree (Art. 8(2)(3)). Manufacturing of dual-use products is already codified in EU legislation and subject to licensing and export controls as well as military equipment, which are subject to export controls according to the Dutch ‘export of strategic goods’ legislation of 2012 (Art. 8 1(a)(b)). In this category, by government decree, a new technology may be designated as a sensitive technology. Importantly, the legislation stipulates that both parliamentary chambers need to be consulted when any changes are made with regards to the sectoral coverage of the legislation, significantly limiting government discretion in that area. It is the strictest way to phrase this particular procedure of changes by governmental decree. An interesting amendment to the proposed legislation concerns the screening of investments in entities that administrate business parks and bring public-private initiatives together to work on technological advancement and applications of strategic or economic value to the Netherlands (Art. 1; Art. 6).

Notification requirements are ‘land-neutral’ and apply to all investors (both domestic and foreign), in contrast to most ISMs in Europe. The thresholds for notification in the legislation are defined in terms of change of control and significant influence (‘significante invloed’). The term control is extrapolated from Dutch competition law while significant influence is defined in terms of the extension of voting rights in general meetings (Art. 4) and applies to sensitive technologies only. The thresholds for investment screening are low, especially in sectors of sensitive technologies, where the acquisition of a 10% share can already trigger a review process depending on the activity of the relevant firm. Once a notification is made, the relevant authorities will normally communicate within eight weeks (60 calendar days) whether a review process is required (Art. 12(1)). The same timeframe applies to the making of a decision (Art. 12(6)). In case no decision or communication is made within that timeframe, no screening decision will be required, and the investment can be considered approved (Art. 12(4)). The decision to review, reject, mitigate, or accept an investment is taken by the Minister of Economic Affairs & Climate and the Minister of Justice & Security (Art. 10 (2)). Depending on the nature of the investment, other governmental branches can be involved to provide information or expertise, but this is not mandatory. When communicating a decision, the Minister is bound by the considerations outlined in the law (Art. 19-22) and must motivate its decision.

With regard to ex-post screening, the Dutch ISM is limited: the Ministry has a window of eight months after the promulgation of the law to screen investments made before the implementation of the ISM. The ex-post time-frame only covers transactions concluded or initiated in the period between 2 June 2020 and the
official entry into force of the ISM (1 June 2023), under the condition that they have not yet been subject to a public interest intervention under the existing sector-specific regime (van den Berg & Immerzeel, 2022). Additionally, the Ministry is allowed to review ex-post a previous screening decision if new information or developments result in important consequences for the Dutch national interest (Art. 27 1(a)(b)). This can only happen after consultation with the Council of Ministers, within a specific time-frame, and if the specific conditions outlined in Art 27 are met. In case of re-opening, the investor can also claim compensation for losses that result from the revised decision (Art 27(5)), a provision rarely found in other ISMs and which holds the Ministry financially accountable for any losses incurred from ex-post reversals of screening decisions. Lastly, firms can file for the reconsideration of ISM decisions through administrative objection, or launch an appeal at the Rotterdam District Court and the Industry Appeal Tribunal (MEZK, 2020; Oosterhuis et al., 2021, p. 120).

Discussion

In line with our expectations, we found that the Dutch ISM is limited in scope, sports a narrow review authority, and contains specific provisions in the legislation to protect foreign investors, especially through short timeframes and the limitations on ex-post screening that uniquely allows for compensation requests in case of damages. A narrow committee ensures that economic interests can counterbalance considerations of national security to a considerable extent.

We also found clear evidence of firm lobbying activity in line with our expectations. Private businesses lobbied the government and expressed their preferences for an ISM with narrowly defined parameters, limited in scope, that avoids government discretion in screening cases (MEZK, 2020; VNO-NCW & MKB-Nederland, 2020). The creation of the national ISM was supported by the two largest Dutch business associations MKB-Nederland and VNO-NCW, insofar it had a limited and clearly defined scope with a focus on legal certainty (ibid.). They specifically aimed to limit government discretion in adding new sectors to the scope of the ISM through governmental decree, and business associations gained the reassurance that no changes would be made without the necessary consultations and will be subject to parliamentary control (MEZK, 2020). They also pushed for the clarification of the notification thresholds that would be applicable, especially with regards to the new legal concept of ‘significant influence’ (MEZK, 2020). In line with our expectations, private industry protested against the vagueness on what constitutes ‘national security’. Yet, it was unsuccessful in restraining government discretion and flexibility on this point. Our general expectations are clearly born out though: private business pushed for legal clarity, the limitation of government discretion, and limitation in scope.

Concerning investor protection built into the ISM, we find that Dutch business associations lobbied for clarifications regarding the procedure to re-open any previously taken screening decision. They also lobbied to limit ex-post screening competences to only six months before the entering into force of the legislation rather than 2 June 2020. They argued that the period was too long and would create too much uncertainty for investors and their Dutch counterparts. This, again, is in line with our expected firm behavior.
Plausibility check

To strengthen our argument, we coded all European ISMs to assess whether our explanation holds for more cases and to demonstrate the usefulness of our conceptualization of ISMs. We relied on the PRISM database to code our scope variable and we complemented it with newly collected data on scope, screening authorities, and formal investor protection. We also added variables on silent positives, time-frame, ex post screening, and on the possibility of appeal.20

According to our preliminary analysis, out of 29 European countries, nine have closed ISMs (Denmark, Estonia, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Slovenia), while 14 have open ISMs (Austria, Belgium, Czech Republic, Finland, France, Germany, Hungary, Italy, Poland, Portugal, Romania, Slovakia, Spain, Sweden, UK). The remaining six countries (Bulgaria, Croatia, Cyprus, Greece, Ireland, Switzerland) had no ISMs in force at the time of writing. Table 4 summarizes the findings for every country.21

Two observations are important to contextualize our findings. First, we observe a general correspondence between public and private governance ecosystems and the development of open and closed ISMs, respectively. It is not surprising that continental European countries such as France, Italy, and Germany (usually considered public governance ecosystems) are characterized by open ISMs, whereas Northern European or Baltic countries (private governance ecosystems) adopted closed ISMs. Admittedly, it is challenging to categorize all

<table>
<thead>
<tr>
<th>Country</th>
<th>ISM</th>
<th>Scope</th>
<th>Authority</th>
<th>Investor protection</th>
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<tbody>
<tr>
<td>Austria</td>
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<td>Broad</td>
<td>Broad</td>
<td>High</td>
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<tr>
<td>Belgium</td>
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<td>Specific</td>
<td>Broad</td>
<td>Low</td>
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<td>Broad</td>
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<td>Narrow</td>
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<td>Estonia</td>
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<tr>
<td>United Kingdom</td>
<td>Open</td>
<td>Broad</td>
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See Annex for our coding strategy and additional information.
European member states according to their governance ecosystems. For this plausibility check, we have relied heavily on the VoC literature which shows a trend towards public governance ecosystems in southern European states and private governance ecosystems in northern European states, with central Europe often having characteristics of both. While our case studies relied on previous works involving France and the Netherlands in the context of private and public governance ecosystems, this data was not available for the majority of European countries. For the most accurate categorization of governance ecosystems, much more in-depth analysis is necessary. Our plausibility check therefore highlights the importance of triangulating existing databases with primary sources, legal documents with secondary literature and in-depth qualitative case-studies. Secondly, this cursory analysis highlights some important anomalies that warrant further inquiry. The UK, for example, despite being a private governance ecosystem, has an open ISM which could be related to the UK’s exit from the EU and the need for flexible tools to navigate FDI regulations (Calcara, 2022). Overall, our plausibility check emphasizes the need for future efforts to establish causality between governance ecosystems and the institutional configuration of ISMs, even if this analysis provides a good starting point for data generation in this field of research.

Conclusions

The research findings confirm that our theory of public/private governance ecosystems may well explain cross-country differences in the institutional configuration of ISMs. In line with our hypotheses, countries with public governance ecosystems are likely to have an open ISM and countries with private governance ecosystems a closed ISM. We also show that governments and firms behaved as expected in our case studies. In the public governance ecosystem, the government preferred an open ISM to maintain control over strategic sectors. Firms accepted a broad configuration of ISM because they can capitalize on their privileged formal and informal relationship with the government. In our private governance ecosystem, both the government and firms have an incentive to set more specific boundaries for ISMs; the former because they are less concerned about possible external interference in government-firm networks; the latter because they are more dependent on international markets than on their privileged relationship with the government.

Our paper makes three contributions to the literature. First, it provides a theoretical framework that can be used to understand cross-country variations in ISMs. Rather than assuming that all states will intervene in their own economies in the same way and at their own discretion, we show that different state-industry governance ecosystems influence the adoption of new institutions and laws. Second, we provide an empirical and methodological contribution to the emerging literature on ISMs, both by identifying their specific properties that allow for a systematic comparison among them, and by combining in-depth qualitative studies with a rich dataset. Third, our paper engages in a complementary dialogue with scholarship on the role of state authority in the global economy (Milner, 2021), the structural power of firms (Culpepper & Thelen, 2020; Malkin, 2022), and weaponized interdependence (Farrell & Newman, 2019). This contribution is therefore timely to gauge the European ambitions for strategic autonomy in critical sectors (Ramahandry et al., 2021).
We believe our paper opens up several avenues of research. First, this study needs to be extended to understand whether and how exogenous drivers (including the rise of China, the geopoliticization of trade or globalization backlash) affect state-firm relations, and whether this in turn leads to further changes in domestic ISMs. For example, existing research has noted how external vulnerability impacts the composition of elite networks, but does so mainly at the sectoral level (Katzenstein, 1985). Adding a sectoral dimension to our framework might help to understand how state-industry relations affect different forms of screening in certain sectors (Reurink & Garcia-Bernardo, 2021), and how cross-country public-private partnerships could lead to certain sectors being more or less exposed to regulation (Tsingou, 2015). Second, future studies may work to refine our ideal types and extend the framework to cases where rather than mutually reinforcing, the variables are substitutes. An example would be ecosystems characterized by low levels of government ownership but high levels of public-private interpenetration, such as the US.

In this paper, we emphasize continuity more than change in how states balance security and economics, but this framework needs to include possible drivers of change. From a theoretical perspective, therefore, we believe that there is fertile ground to understand how and when exogenous and systemic factors bring about significant and lasting changes to domestic state-industry relations (Blyth & Schwartz, 2022). Second, our theory would benefit from being extended to analyse how domestic state-firm relations influence country-level preferences at the European and global stage. Future studies could investigate whether and how European FDI regulations are mediated by different member states’ preferences, which are the products of domestic specific state-firm relations. This never-ending dialogue between endogenous and exogenous factors, between domestic and international politics, is, in our view, a key point for understanding today’s economic and political factors of continuity and change in global investment regulation.

Notes

1. We use the term ‘formal’ here to indicate that we make no claims as to the real level of investor protection for foreign investors. It indicates that the investor protection is codified in law, rather than dependent on informal guarantees and relations between the state and firms.
2. The Regulation (EU) 2019/452 states that foreign investors shall have the possibility to seek recourse against screening decisions of the national authorities. However, seek recourse is a vague description which governments can interpret in different ways (Hallberg, 2020).
3. Over 60 calendar days (PRISM, 2022).
4. 60 or less than 60 calendar days (PRISM, 2022).
5. It is possible to define governance structures as the general rules that delineate how industrial sectors should be organized and manifested both in the law and through informal institutional practices (Fligstein, 2001).
6. This assumption does not imply that, although formal and informal features tend to be mutually reinforcing, they may also be substitutes in empirical cases. For example, informal interactions between states and industries could substitute for and bridge the absence of formal and institutionalized relations between the public and the private sector. We thank one of the reviewers RIPE for highlighting this point.
7. For a nuanced conceptualization of state-business relations in different political and institutional settings see Culpepper (2012).
8. On within-case variation see Skarbek (2020).
10. The government relied on its informal relationships with French firms to solve this problem. Bouygues, a French construction and telecommunications giant and Alstom’s largest shareholder, voluntarily (and apparently without receiving anything in return) lent the French state its voting rights in the company and gave the state an option to buy a 20% stake at a premium to market prices (Reuters, 2014). To be sure, the French government was not alone in exerting pressure on strategic firms. US pressure on Alstom’s top executives reportedly led to a takeover of its energy division (The Economist, 2019).
11. As defined in Article L.233-3 of the French Commercial Code.
13. We thank one of the reviewers RIPE for highlighting this point.
14. This has been interpreted as an indirect intervention by the Dutch government (Tamminga, 2017; Trends Knack, 2016).
15. Ministerie van Economische Zaken en Klimaat (MEZK) 2022. The government is currently also working on a proposal for another sectoral screening law specifically for the defense sector (Tweede Kamer der Staten-Generaal, 2023, p. 9).
16. ‘Algemene Maatregel van Bestuur’ (AMvB) is a governmental decree that allows for a simplified procedure to further specify or amend certain aspects of a law. The procedure can vary depending on how it is worded within the legislation.
17. This addition explicitly came in response to the controversial sale of part of the infrastructure of the High-Tech Campus in Eindhoven to a Singaporean state-fund (Couwenbergh et al., 2022; Tweede Kamer der Staten-Generaal, 2022).
18. ‘Zeggenschap’ or control, as defined in Art 26 of the Dutch competition law (‘Mededingingswet’).
19. Oosterhuis et al. (2021, p. 120). See also CJEU ‘Xella’ judgement on the importance of justifying a specific screening decision in line with EU legislation (Ianc et al., 2023).
20. See Annex for our coding strategy.
21. The data was last updated in January 2024. Ireland is not included as its ISM will not come into force until the second quarter of 2024.
22. For a more detailed distinction between public and private governance ecosystems, see Calcara (2022).

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Disclosure statement

The authors report there are no competing interests to declare.

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MEZK. (2022). Wet van 18 mei 2022, houdende regels tot invoering van een toets betreffende verworvenactiviteiten die een risico kunnen vormen voor de nationale veiligheid gezien het effect hiervan op vitale aanbieders, beheerders van bedrijfscampus of ondernemingen die actief zijn op het gebied van sensitieve technologie (Wet veiligheidstoets investeringen, fusies en overnames). Staatsblad 2022, 215.


