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The European Union’s Foreign Direct Investment Screening Paradox: Tightening Inward Investment Control to Further External Investment Liberalization

Stephan W. Schill*

This article analyses the justification for the recent enactment in the European Union (EU) of a regulation establishing a framework for the screening of inward foreign direct investment (FDI). It argues that the new regulation, which constitutes a first step for a more comprehensive EU investment screening system, should not be considered to be exclusively aimed at protecting the internal market and defensive Union or Member State interests. Instead, the regulation has a tangible external economic policy justification and outlook because it can be seen as a starting point to build up, at the Union level, possibilities to limit inward FDI, which in turn can be used by the EU as a bargaining chip in its trade and investment negotiations with economically powerful countries, such as the United States or China, in order to achieve, on the basis of reciprocity, better access of EU investors to foreign markets. Paradoxically, establishing a framework for the screening of inward FDI at the Union level can therefore be seen as serving the EU’s constitutionally enshrined goal to achieve further investment liberalization, rather than as shielding the internal market from undesired external influence.

1 THE FOREIGN DIRECT INVESTMENT SCREENING PARADOX

With the enactment of a ‘Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for screening of

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foreign direct investments into the Union, the European Union (EU) is joining the ranks of economies, such as the United States and China, that have a mechanism for the screening of inward foreign direct investment (FDI) in respect of certain strategic industrial sectors. The Regulation establishes a ‘mechanism for cooperation between Member States, and between Member States and the Commission, with regard to foreign direct investments likely to affect security or public order’. At the same time, the Regulation maintains the Member States’ ultimate authority for concrete screening decisions and unequivocally states that it is each Member State who has the ‘sole responsibility for its national security’ and ‘the right to take utmost account of its essential security interests’. The principal instruments of cooperation are mechanisms for notifications and for sharing information on FDI screening among Member States and between Member States and the Commission and the possibility for the Commission to issue non-binding opinions to Member States regarding the screening of concrete FDI projects. The Regulation therefore does not establish, as originally proposed by the Commission, an independent Union level FDI screening mechanism whenever ‘Union interests’ are at stake.

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1 See [2019] Official Journal L 79/1 1.
3 Art. 1(1) of Regulation (EU) 2019/452.
4 Art. 1(2) of Regulation (EU) 2019/452.
5 See Arts 6–13 of Regulation (EU) 2019/452.
6 See European Commission, Proposal for a Regulation of the European Parliament and of the Council Establishing a Framework for Screening of Foreign Direct Investments into the European Union COM(2017)487 final (13 Sept. 2017). According to the Commission’s proposal, the FDI screening mechanism would have included independent screening powers for the Commission for ‘foreign direct investments that are likely to affect projects or programmes of Union interest on the grounds of security and public order’ (Art. 3(2) of the Commission Proposal). Depending on need, this authorization could potentially have been applied broadly, as the notion of ‘Union interest’ and the factors that were to be taken into account by the Commission in the screening were only indicative (see Arts 3(3) and 4 of the Commission Proposal). The adopted Regulation, by contrast, limits the Commission to issuing non-binding opinions to Member States in case it considers that a certain FDI project ‘is likely to affect projects or programmes of the Union interest on grounds of security or public order’ (Art. 8(1) of Regulation (EU) 2019/452). Member States have to ‘take utmost account of the Commission’s opinion and provide an explanation to the Commission in case its opinion is not followed’ (Art. 8(2)(c) of Regulation (EU) 2019/452). Furthermore, the list of projects and programs of Union interest annexed to the Regulation is formulated as a closed list. An amendment of that list can be made by the Commission as a delegated act (Art. 8(4) of Regulation (EU) 2019/452). This delegation can be revoked at any time by the European Parliament or the Council (Art. 16(5) of Regulation (EU) 2019/452). In addition, there are procedural steps the Commission has to abide by. These include the duty to consult experts designated by each Member State (Art. 16(4) of Regulation (EU) 2019/452) and to notify the European Parliament and the Council of any amendment (Art. 16(5) of Regulation (EU) 2019/452). The final text was agreed on as part of an interinstitutional negotiation. See European Parliament, Provisional Agreement Resulting from Interinstitutional Negotiations (6 Dec. 2018) (PE-CONS No/YY – 2017/0224 (COD)).
This notwithstanding, the new regulation is often seen as constituting a first step towards the establishment of a broader EU mechanism for FDI screening that has the objective of protecting strategic Union interests.⁷ This can be seen not least from the context in which the Regulation is generally placed. The President of the European Commission, Jean-Claude Juncker, for example, stresses the protection of European interests as the driving concern. In his words:

Europe must always defend its strategic interests and that is precisely what this new framework will help us to do. This is what I mean when I say that we are not naïve free traders. We need scrutiny over purchases by foreign companies that target Europe’s strategic assets.⁸

Juncker’s statement suggests that the primary motivation for introducing an FDI screening mechanism at Union level is the protection of the EU’s internal market against the involvement of foreign investors in specific, strategic FDI projects.

At the same time, the basis of competence chosen for the new regulation is not the provision connected to free movement of capital in the internal market, which empowers the European Parliament and the Council to ‘adopt the measures on the movement of capital to or from third countries involving direct investment’ (Article 64(2) of the Treaty on the Functioning of the European Union – TFEU), but the EU’s Common Commercial Policy (Article 207(2) TFEU).⁹ This begs the question of whether the new regulation is truly aimed at regulating inward FDI and imposing certain restrictions to protect Union and Member States internal interests – and may therefore even be an indication of mounting protectionism and economic nationalism in Europe¹⁰ – or whether it has to be seen as a building block for the global investment architecture that the EU has started developing since the Lisbon Treaty conferred to it a new competence for ‘foreign direct investment’ as part of its Common Commercial Policy (Article 207(1) TFEU).

In engaging with this question, the present article argues that the new EU framework on FDI screening can be explained by what can be called an ‘investment screening paradox’. This paradox refers to the fact that the immediate effect of the new

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⁷ See e.g. Carlos Esplugues, A Future European FDI Screening System: Solution or Problem? Columbia FDI Perspectives No. 245 (11 Feb. 2019).
¹⁰ For such a perspective on FDI screening generally, see e.g. United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2018: Investment and New Industrial Policies 83–84 (United Nations 2018).
FDI screening mechanism of tightening control over, and therefore restricting, inward investment flows has the objective of achieving further investment liberalization in foreign markets in the future. One of the new regulation’s goals, this article argues, goes much beyond the creation of a framework to protect the internal market and specific defensive public policy interests of either the EU or its Member States. Instead, the Regulation creates new tools for screening inward FDI which have a tangible external economic policy justification and outlook. They empower the EU in its trade and investment negotiations with third countries to achieve, on the basis of reciprocity, better access of EU investors to third-country markets in return for limiting screening in the EU of inward FDI coming from the EU’s treaty partners. In that perspective, the Regulation is not motivated by EU protectionism. Instead, and somewhat paradoxically, it is a building block in the EU’s broader external economic policy agenda to achieve further liberalization of FDI flows at a global level and an implementation of its constitutional mandate to this effect. The new framework for FDI screening, despite its relative weakness as compared to what the Commission had initially proposed, strengthens the EU’s bargaining power in bilateral negotiations with economically powerful countries, such as the United States and particularly China, with whom the EU seeks to establish comprehensive treaty rules governing reciprocal access for, and protection of, foreign investment.\(^1\)

In order to build up this argument, Part 2 of this article puts the establishment of an EU FDI screening mechanism into the context of the EU aiming to become a rule-maker that influences and shapes international investment law at a global level according to objectives laid down by EU constitutional law. Pursuant to Article 21 TEU, these objectives encompass achieving further investment liberalization and shaping international investment relations according to the EU’s own constitutional values to promote and protect, amongst other, democracy, the rule of law, and human rights. Part 3 then addresses the obstacles EU constitutional law presents, in the form of the free movement of capital in relation to third countries, which only became part of EU law with the 1993 Maastricht Treaty,\(^12\) to the EU negotiating effectively for further investment liberalization in particular in bilateral settings with economically powerful countries as counterparts. Part 4 then compares the situation under EU constitutional law to the constitutional framework in force in Germany, which accords foreign investors in important regards a constitutional status that differs from that of nationals. This comparison reinforces the point that an EU framework addressing inward FDI screening fulfils the important function of achieving one constitutional objective, i.e., strengthening the

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EU’s external negotiation power, which is weakened by another area of EU constitutional law, namely the EU’s internal market rules.

After explaining the rationale of the introduction of EU FDI screening mechanisms as an attempt to mitigate between competing constitutional norms, Part 5 closes by turning to the critical role the Court of Justice of the European Union (CJEU) currently plays, through its jurisprudence on the constitutional principle of the autonomy of EU law, as a constitutional arbiter in empowering or constraining the ability of the political branches of the EU to meet their constitutional objective to shape international investment relations in line with the values laid down in Article 21 TEU.

2 THE EU AS AN EMERGING RULE-MAKER IN INTERNATIONAL INVESTMENT LAW

Prior to the entry into force of the Lisbon Treaty, the EU had played only a smaller role in shaping international investment law directly at the global level. It had done so through its participation in the World Trade Organization (WTO) and the Organisation for Economic Co-operation and Development (OECD), both of which have created a (limited) set of rules for investment liberalization.\textsuperscript{13} By contrast, the – in practice – most important area of international investment law, namely the law of international investment protection and investor-state dispute settlement (ISDS), has long been under the exclusive ambit of Member States who have concluded almost 1,600 international investment agreements (IIAs), both amongst themselves (intra-EU) and with third countries (extra-EU).\textsuperscript{14}

The Lisbon Treaty has brought a major change in this respect, with Article 207(1) TFEU integrating ‘foreign direct investment’ into the EU’s common commercial policy.\textsuperscript{15} While the scope of this competence has, for almost a decade, remained


\textsuperscript{14} UNCTAD lists a total of 1,590 IIAs with at least one EU Member State as party, including 195 intra-EU and 1,395 extra-EU agreements. This excludes replaced and terminated treaties. See UNCTAD, International Investment Agreements Navigator: Advanced Search (2018), http://investmentpolicyhub.unctad.org/IIA/AdvancedSearchBIT (5 Mar. 2019).

\textsuperscript{15} Comprehensively on the EU and its engagement with international investment law, see Angelos Dimopoulos, EU Foreign Investment Law (OUP 2011); Catharine Titi, International Investment Law and
contested, the CJEU has recently clarified in Opinion 2/15 that it encompassed both investment liberalization in the pre-establishment phase and substantive investment protection post-establishment.\(^{16}\) The Court has held, however, that portfolio investment and ISDS were not covered by Article 207(1) TFEU and remained under shared competences.\(^{17}\) In practice, this division of competences has the consequence that agreements covering both foreign direct and portfolio investments and/or ISDS – at least when they allow recourse against Member States – will be concluded as mixed agreements, or will incrementally disappear because their ratification at the EU and Member State levels is too cumbersome.\(^{18}\) While the Comprehensive Economic and Trade Agreement between the EU and Canada has been concluded as a mixed agreement, in respect of the free trade agreements with Singapore and Vietnam, the investment chapters that were originally part of the respective agreements have been sourced into separate investment agreements in order to keep the trade aspects of the agreements under exclusive Union competence.\(^{19}\) In either event, the negotiation of such agreements, whether they are mixed or concluded as EU-only agreements, generally lies with the Commission.\(^{20}\)

The Commission had already started, soon after the entry into force of the Lisbon Treaty, to fill the EU’s new competence with life. It had first done so in a Communication in July 2010, in which it sketched out the contours and objectives of the EU’s future international investment policy, terming it ‘the new frontier for

\(^{16}\) CJEU, Opinion 2/15 – Free Trade Agreement with Singapore (16 May 2017) paras 78–110.

\(^{17}\) Ibid., paras 238, 243 (non-direct investment) and 293 (ISDS).


the common commercial policy’. Expressing itself favourably concerning the
general benefits of investment flows for economic growth, employment, and develop-
ment, the Commission acknowledged the leading position of the EU to shape the
law governing international investment relations. While building on ‘best practices’
of Member States,’ the Commission stressed that the EU had better leverage in
negotiating rules with third countries than Member States acting individually. It
could thus better ‘ensure that EU investors abroad enjoy a level-playing field, which
assures uniform and optimal conditions for investment through the progressive
abolition of restrictions on investment’. The abolition of such restrictions is
imperative for the EU, not least because of the mounting significance of global
value chains and services trade. That achieving further market access and investment liberalization were among
the core goals of the EU’s common commercial policy was also echoed by the
Council, which emphasized, in its reaction to the Commission’s July 2010
Communication, that EU IIAs should provide for ‘effective and ambitious invest-
ment protection and market access’. Similarly, the European Parliament, while
stressing the need for transparency in international trade negotiations, and expressing
concerns about the effect of IIAs on certain sensitive areas of public policy-making,
recognized the importance of the external dimensions of investment protection and liberalization. It emphasized, inter alia, that ‘investor protection for all EU investors
must remain the first priority of investment agreements’ and highlighted the need
to ‘ensure reciprocity when negotiating market access with its main developed
trading partners and the major emerging economies’.

The objective of further investment liberalization has also been translated into
actual trade and investment agreements that the EU has concluded as part of its post-
Lisbon common commercial policy. Thus, agreements like the EU–Canada
Comprehensive Economic and Trade Agreement (CETA), as well as the agreements
concluded with Vietnam and Singapore, contain market access commitments for
foreign investors that go beyond the pre-existing frameworks.

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22 Ibid., at 8.
23 Ibid., at 4–5 (quote at 4).
27 Ibid., para. 21.
At the same time, while incrementally replacing Member States as the main actors in international investment law, the EU’s ambition is not simply to continue past policies, but to engage in a comprehensive reform of this field of international law. This already transpired when the Commission stressed, in its July 2010 Communication, the need for ‘balance’ between investor interests and regulation in the public interest. The desire for reform became acute though after public criticism of international investment law and ISDS mounted when plans to negotiate the Transatlantic Trade and Investment Partnership (TTIP) with the United States crystallized in 2014.

Following a ‘Public consultation on modalities for investment protection and ISDS in TTIP’ conducted in reaction to that criticism, the Commission formulated reform objectives for the EU’s foreign investment policy and IIA practice. On substance, IIAs should not negatively impact the right to regulate, inter alia, through clearer formulation of substantive standards of treatment, carve-outs, exception clauses, and institutional rules to control the interpretation and application of IIAs. On procedure, the Commission suggested a fundamental shift in ISDS from a reformed version of investor-state arbitration to the establishment of a permanent, two-tiered ‘investment court system’. The Commission proposed this system first in the TTIP negotiations and since has managed to include it in CETA and in the

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investment agreements with Vietnam and Singapore. Likewise, the free trade agreement between the EU and Mexico is to contain a version of the investment court system. In parallel, the EU is also pushing for the establishment of a permanent international investment court at the multilateral level.

Both the integration of market access and investment liberalization and the efforts to reform international investment law are not only matters of EU policy. Both aspects mirror the constitutional framework the Lisbon Treaty has set up for the EU’s external relations, including the Common Commercial Policy. As stated in Article 207(1) TFEU, ‘the common commercial policy shall be conducted in the context of the principles and objectives of the Unions external action’. These principles, in turn, are set out in Article 21(1) and (2) TEU. Article 21(1) subparagraph 1 TEU lays out the general principles guiding EU external relations as follows:

The Union’s action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law.

These objectives, as further set out in Article 21(2) TEU, are to be translated into common policies and concrete actions and include, as relevant for international trade and investment relations, ‘encourag[ing] the integration of all countries into the world economy, including through the progressive abolition of restrictions on international trade and actions that ‘ensure sustainable development’ and ‘good global governance’. Article 21 TEU therefore sets out how the EU should shape the law of globalization through its external relations and the treaty frameworks it participates in.

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39 Art. 21(2)(e) TEU.
40 Art. 21(2)(f) TEU.
41 Art. 21(2)(h) TEU.
Meanwhile the Commission has interlaced its policy on external trade and investment with the Lisbon Treaty’s constitutional foundations in a 2015 Communication entitled ‘Trade for All: Towards a More Responsible Trade and Investment Policy’.42 In it, the Commission expresses the connection between the EU’s trade and investment policy and its basic constitutional values as follows:

EU trade policy is for all. It seeks to improve conditions for citizens, consumers, workers and the self-employed, small, medium and large enterprises, and the poorest in developing countries, and addresses the concerns of those who feel they are losing out from globalisation. While trade policy must deliver growth, jobs and innovation, it must also be consistent with the principles of the European model. It must, in short, be responsible. It must be effective at actually delivering economic opportunities. It must be transparent and open to public scrutiny. It must promote and defend European values.43

In the Commission’s view, a value-based trade and investment policy entails the promotion of a new approach to investment, not only insofar as it relates to the EU, but to the entire world. Indeed, the Commission considers that ‘[t]he EU is best placed – and has a special responsibility – to lead the reform of the global investment regime, as its founder and main actor’.44 This reform, in turn, should be guided by connecting the EU’s trade and investment policy, in line with Article 21 TEU, to the goals of promoting sustainable development, human rights, and good governance.45

Key in this context are also the forms and fora through which to implement the EU’s Common Commercial Policy and its efforts to reform international investment law. While stressing its interest in using multilateral settings, in line with the demand in Article 21(2)(h) TEU to ‘promote an international system based on stronger multilateral cooperation’, the Commission also acknowledges the need to ‘mov[e] forward bilateral relationships’ and to determine EU ‘priorities to open negotiations ... primarily based on economic criteria’.46 This encompasses, above all, negotiations with economically particularly important actors, like the United States, with whom the EU wants to achieve ‘an ambitious and balanced market access package comparable to the EU’s FTA with Canada’47 and China, where ‘European participation in China’s “One belt, one road” projects’ is key.48 In both cases, effective commitments to have access to US and Chinese markets is of preeminent importance for the EU.

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43 Ibid., at 3.
44 Ibid., at 15.
46 Ibid., at 20 ff (quotes at 22).
47 Ibid., at 22.
All in all, as this Part has shown, the progressive abolition of restrictions on international trade and investment constitutes a constitutional mandate for the EU’s common commercial policy. Similarly, the efforts by the EU to reform international investment law correspond to the constitutional objective of the common commercial policy to promote democracy, the rule of law, human rights, sustainable development, and global governance. It is this broader context in which the analysis of the new EU FDI screening framework should be placed. Once this is done, it should become clear that that framework can be explained not only as an instrument to protect defensive EU interests, but also has the function of helping to overcome obstacles that exist elsewhere in the EU’s constitutional law to implementing the EU’s constitutional mandate to liberalize investment flows and to reform international investment law, in particular, as the need for bilateral negotiations of trade and investment agreements increases.

3 EU CONSTITUTIONAL LAW AS AN OBSTACLE TO EU BARGAINING FOR INVESTMENT LIBERALIZATION IN BILATERAL NEGOTIATIONS

Notwithstanding the mandate in Article 21 TEU to shape the law of globalization in line with the EU’s core constitutional values (rule of law, democracy, human rights, and sustainable development), EU constitutional law creates significant obstacles for fulfilling this mandate effectively in treaty negotiations with third countries. Most importantly, the free movement of capital in relation to third countries, which is laid down in Article 63 TFEU as part of the EU’s internal market rules, puts the EU in a relatively weak negotiating position when seeking to bargain for more investment liberalization and greater access for its own investors to the markets of third countries. As I will show, this internal market rule constitutes an obstacle for successful and efficient EU bargaining in particular in bilateral settings, which, even though Article 21(2)(h) TEU generally disfavors them compared to multilateral ones, become increasingly prevalent. The introduction of an EU framework for inward FDI screening closes this gap between external policy mandate and internal constitutional rules and brings the situation in the EU closer to that in place in the constitutional order of other economic powers whose ability to access foreign markets through trade and investment has been key for success, for example that of Germany addressed in Part 4.

To start, it is important to understand how the rules on free movement of capital in the TFEU reduce the EU’s bargaining power in respect of investment liberalization with third countries, in particular in light of the fact that a considerable amount of foreign investment activities that qualify as FDI from the perspective of IIAs are covered already by the freedom of capital movement under EU law. Sedes
materiae in this respect is Article 63 TFEU which provides that ‘all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited’.

Introduced by the Treaty of Maastricht,49 and unlike its predecessor in Article 67 of the Treaty of Rome,50 Article 63 TFEU is the only fundamental freedom in the EU that not only applies in an intra-EU context, but also applies in relation to, and for the benefit of, third-country nationals. Subject to a number of exceptions laid down in Article 65 TFEU, inter alia, to protect ‘public policy or public security,’ Article 63 TFEU grants a right to non-discriminatory market access as a corollary of the prohibition of restrictions on the movement of capital from third countries. Its objective is, as stated in Article 64(2) TFEU, ‘to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible’. Of relevance in the present context, Article 63 TFEU not only applies to portfolio investments,51 but also covers economic activities that qualify as FDI in the sense used in IIAs.

In fact, pursuant to Annex I of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty,52 which the CJEU still consistently uses to determine the scope of application of Article 63 TFEU,53 even though it was passed to implement the predecessor provision of Article 63 TFEU under the Treaty of Rome, the notion of ‘capital movement’ encompasses a list of economic activities, which includes:

I – DIRECT INVESTMENTS:
1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.
2. Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.
3. Long-term loans with a view to establishing or maintaining lasting economic links.
4. Reinvestment of profits with a view to maintaining lasting economic links.
A – Direct investments on national territory by non-residents
B – Direct investments abroad by residents

II – INVESTMENTS IN REAL ESTATE (not included under I)
A – Investments in real estate on national territory by non-residents
B – Investments in real estate abroad by residents

49 See supra n. 12.
53 For a recent example see CJEU, Joined Cases C-52/16 and C-113/16, SEGRO and Horváth, ECLI:EU:C:2018:157, para. 56.
As a consequence of this wide definition of 'capital movement', many economic activities that qualify as FDI from the perspective of IIAs fall under the scope of the freedom of capital movements in Article 63 TFEU and thus give a right to foreign investors to market access within the limits of that fundamental freedom. Article 63 TFEU thus applies to 'investments in real estate' and constrains, inter alia, limitations on the acquisition of real estate by foreign investors, both in case of direct and indirect investments through a company incorporated in the host State that is foreign owned and controlled. But it also applies to all activities that qualify as 'direct investments' in the sense of Annex 1 of Directive 88/361/EEC, which includes the establishment of greenfield investment and the acquisition of brownfield investment through mergers and acquisitions. Also in those cases, the rules on free movement of capital in principle give third-country investors a right to access the EU market.

54 But it also applies to all activities that qualify as ‘direct investments’ in the sense of Annex 1 of Directive 88/361/EEC, which includes the establishment of greenfield investment and the acquisition of brownfield investment through mergers and acquisitions. Also in those cases, the rules on free movement of capital in principle give third-country investors a right to access the EU market. 55

The only carve-out from the application of market access rights under the free movement of capital in relation to third-country investors investing in the EU, which the CJEU has recognized, concerns market access restrictions that fall under the freedom of establishment pursuant to Article 49 TFEU. In respect of such measures, the CJEU reasoned:

Since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with third countries does not enable economic operators who do not fall within the limits of the territorial scope of freedom of establishment to profit from that freedom. Such a risk does not exist in a situation such as that at issue in the main proceedings. The legislation of the Member State in question does not relate to the conditions for access of a company from that Member State to the market in a third country or of a company from a third country to the market in that Member State. 56

According to this reasoning, market access restrictions affecting extra-EU investors that fall under Article 49 TFEU cannot be assessed under the free movement of capital as this would in effect give those investors a right of establishment in the EU, which they do not have pursuant to Article 49 TFEU.

The difficulty in respect of market access restrictions of extra-EU investment, of course, is in determining when the freedom of establishment is affected in case of direct investments. To the extent assets other than shareholdings in companies established in the host State are concerned, any restrictions concerning market access would seem to fall exclusively within the scope of application of the freedom of capital movement. Indeed, in respect of restrictions to acquire real estate in an EU Member State, the CJEU recently held:

54 See ibid., paras 50–60.
55 See CJEU, Case C-47/12, Kronos, ECLI:EU:C:2014:2200, paras 40–42.
56 CJEU, Case C-35/11, Test Claimants (II), ECLI:EU:C:2012:707, para. 100; similarly, CJEU, Case C-47/12, Kronos, ECLI:EU:C:2014:2200, paras 53–54.
When the right to acquire, use or dispose of immovable property on the territory of another Member State is exercised as the corollary of the right of establishment, it generates capital movements. Thus, although that legislation is, prima facie, capable of being covered by both the fundamental freedoms mentioned by the referring court, the fact remains that, in the context of the main proceedings, any restrictions on freedom of establishment resulting from that legislation are an inevitable consequence of the restriction of the free movement of capital and, therefore, do not justify an independent examination of that legislation in the light of Article 49 TFEU.\(^{57}\)

Consequently, market access restrictions that are merely consequences of regulations of capital movement, but that do not prohibit establishment in an EU Member State as such, are not to be assessed under the freedom of establishment under Article 49 TFEU. Extra-EU investors facing restrictions on investing in such assets, in turn, can challenge them by relying on the free movement of capital laid down in Article 63 TFEU.

The situation is different when the incorporation of a local company in a Member State of the EU for purposes of the establishment of a greenfield investment is concerned. Given that the incorporation of a company in a Member State other than the home State constitutes an exercise of the freedom of establishment under Article 49 TFEU,\(^{58}\) third-country investors cannot invoke the free movement of capital to challenge restrictions to incorporate in the EU.

Similarly, the acquisition of brownfield investments through a share deal, that is, the merger with, or acquisition of, existing companies in an EU Member State, falls, under certain circumstances, under the freedom of establishment and cannot be challenged by reliance on the free movement of capital. If the acquisition of a shareholding in a company established in a Member State by a third-country investor is at stake, the CJEU distinguishes in its jurisprudence as follows between the freedom of establishment and the free movement of capital:

As regards the question whether national legislation falls within the scope of one or other of the freedoms of movement, it is clear from well established case-law that the purpose of the legislation concerned must be taken into consideration. National legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company’s decisions and to determine its activities falls within the scope of Article 49 TFEU on freedom of establishment. On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital.\(^{59}\)

\(^{57}\) CJEU, Joined Cases C-52/16 and C-113/16, SEGRO and Horváth, ECLI:EU:C:2018:157, paras 54–55 (internal references omitted).

\(^{58}\) CJEU, Case C-81/87, Daily Mail, ECR 1988, 5483, para. 17.

\(^{59}\) CJEU, Case C-35/11, Test Claimants (II), ECLI:EU:C:2012:707, paras 90–92 (internal references omitted).
When a situation arises in which the CJEU considers that an investor can exercise ‘definite influence’ over a company, in turn, depends on the circumstances of each case.\(^{60}\) No bright line rule exists and the spectrum is wide. While, at one end, no majority shareholding is necessary to establish ‘definite influence’ when other ways of exercising influence exist, at the other end, a participation of 10% will usually not suffice.\(^{61}\)

Despite the uncertainty arising from the CJEU’s jurisprudence on when market access restrictions for the acquisition of shareholdings in companies incorporated in Member States fall under the freedom of establishment, where they cannot be challenged by extra-EU investors, and when the free movement of capital applies, which also protects extra-EU investors, there is a significant spectrum in which third-country investors already have a right to access the EU internal market under the free movement of capital and implement FDI projects including through the acquisition of shareholdings in EU companies.

Moreover, even in situations where market access restrictions only fall under the freedom of establishment, EU law arguably offers possibilities for non-EU investors to benefit from the freedom of establishment and tackle or circumvent market access restrictions, including FDI screenings that exist in some, but not all Member States.\(^{62}\) Non-EU investors can, for example, incorporate in another Member State and, through that corporate vehicle, which qualifies as an EU company, claim the freedom of establishment in the Member State in which they ultimately want to acquire direct influence over a company. Through such structuring, extra-EU investors can potentially circumvent market access restrictions and claim a right to market access even if the free movement of capital was initially not applicable.

All in all, the situation in the EU shows that third-country investors have broad opportunities to invoke internal market law and its fundamental freedoms in order to claim a right to market access without the need for a specific treaty commitment of the EU vis-à-vis the investor’s home State. At the same

\(^{60}\) See CJEU, Case C-47/12, Kronos, ECLI:EU:C:2014:2200, para. 37; Georg Ress & Jörg Ukwow, Artikel 63 AEUV: Freier Kapital- und Zahlungsverkehr, in Das Recht der Europäischen Union, paras 315–16 (Eberhard Gräbner, Meinhard Hilf & Martin Nettlesheim eds, CH Beck 2017). In the same vein, Steffen Hindelang, The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law (OUP 2009) 85 (‘... this study regards as the most appropriate approach a comprehensive overall view of the factual conditions under particular consideration of the applicable company law in the individual case’).


time, the situation under primary EU law constitutes a weakness for the EU’s negotiation power when seeking market access commitment with third countries in trade and investment agreements. After all, as far as the free movement of capital applies, and to the extent possibilities for foreign investors exist to use corporate structures in the EU to benefit from the freedom of establishment, extra-EU investors already have (de iure or de facto) a right to access the EU internal market and to challenge market access restrictions in EU courts. In such a situation, the EU’s counterpart in a treaty negotiation concerning market access for FDI will have little incentive to open its own market to EU investors in return for market access commitments that already exist under EU constitutional law independently of a specific international treaty.

The ability to negotiate for investment liberalization on the basis of reciprocity – market access for EU investors abroad in return for market access for third-country investors in the EU – is therefore significantly limited because of the EU’s internal market rules. This situation may be less problematic in multilateral negotiations where reciprocity is not the key bargaining chip. In bilateral settings, by contrast – which are increasingly important for trade and investment liberalization, both as regards WTO+ commitments and in light of the tangible risk that the WTO dispute settlement system becomes defunct – it can effectively undermine the EU’s negotiation position, in particular with economically powerful states, such as China or the United States. All of this shows that one branch of EU constitutional law, namely its rules on the internal market, could undermine the fulfilment of the objectives of another branch of EU constitutional law, that is, the EU Common Commercial Policy and its objectives to achieve further investment liberalization and to reform international economic law along the lines of the constitutional values listed in Article 21 TEU.

4 EU AND GERMAN CONSTITUTIONAL LAW COMPARED

The difficulties for the EU in negotiating access for its foreign investors to third-country markets, and their origin in the EU’s constitutional structure, become particular clear when comparing the situation under EU constitutional law to that in other countries that prosper economically and do so because they rely on being embedded in an open global economy. A case in point is the situation in Germany, which grants to foreign investors less constitutional protection than it does to nationals, in particular as regards market access. This constitutional setting was crafted post-World War II by the founding fathers of the Grundgesetz (Basic Law), Germany’s Constitution, at a time when Germany had not yet been embedded in the EU common market, precisely in order to empower the German government
to negotiate, based on reciprocity, for market access for its own investors abroad in return for market access of third-country investors in Germany. A more detailed look at the constitutional situation in Germany illustrates this clearly and helps understand the constitutional law dilemma the EU finds itself in.

Although at the level of statutory protection there are few differences between the rights of foreign and of domestic investors in Germany, the Basic Law differentiates between both groups as regards their constitutional status. While both foreign and domestic investors enjoy the right to property under Germany’s Basic Law, other constitutional rights that are key for economic activity only accrue to domestic, not foreign investors. This holds true, above all, for the freedom of profession guaranteed in Article 12 of the Basic Law, which protects against (certain) government restrictions of market access and is the basis for the freedom of enterprise. Similarly, the freedom of assembly guaranteed in Article 9 of the Basic Law, which encompasses the right to establish corporations and the right of employers to associate themselves in employers’ unions and interest associations, only applies to German nationals, not foreigners. Foreigners, in turn, are relegated

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63 For this and the following see ibid., at 503 ff. Differences at the statutory level concern the right of residence and, with regard to foreign legal entities who lack legal personality under German law, the right to operate a business. In few areas, such as arms legislation, nationality may be a ground to deny the issuance of the necessary operating permits. Finally, foreign investment in Germany may be subject to restrictions in order to protect public safety and order. See ibid., at 504–05.

64 Art. 14 [Property, inheritance, expropriation]
   (1) Property and the right of inheritance shall be guaranteed. Their content and limits shall be defined by the laws.
   (2) Property entails obligations. Its use shall also serve the public good.
   (3) Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute respecting the amount of compensation, recourse may be had to the ordinary courts.

65 Art. 12 [Occupational freedom; prohibition of forced labour]
   (1) All Germans shall have the right freely to choose their occupation or profession, their place of work, and their place of training. The practice of an occupation or profession may be regulated by or pursuant to a law.
   (2) No person may be required to perform work of a particular kind except within the framework of a traditional duty of community service that applies generally and equally to all.
   (3) Forced labour may be imposed only on persons deprived of their liberty by the judgment of a court.
   See also Rupert Scholz, Artikel 12 GG, in Grundgesetz-Kommentar, vol II, paras 86, 87 (Theodor Maunz, Günter Dürrg et al. eds, CH Beck 2018).

66 Art. 9 [Freedom of association]
   (1) All Germans shall have the right to form corporations and other associations.
   (2) Associations whose aims or activities contravene the criminal laws, or that are directed against the constitutional order or the concept of international understanding, shall be prohibited.
   (3) The right to form associations to safeguard and improve working and economic conditions shall be guaranteed to every individual and to every occupation or profession. Agreements that restrict or seek
in terms of constitutional protection to the much weaker protections found in the general personal freedom or ‘freedom of action’ laid down in Article 2(1) of the Basic Law.\footnote{Art. 2(1) German Basic Law reads: ‘Every person shall have the right to free development of his personality insofar as he does not violate the rights of others or offend against the constitutional order or the moral law.’ See also Udo Di Fabio, \textit{Artikel 2 Abs 1 GG}, in Maunz, Dürig et al., supra n. 65, vol I, paras 77–81, 92–126.}

Furthermore, the equal protection clause in Article 3 of the Basic Law, which prohibits discrimination, inter alia, based on race and origin, does not prohibit different treatment on the basis of nationality alone.\footnote{Art. 3 [Equality before the law]
(1) All persons shall be equal before the law.
(2) Men and women shall have equal rights. The state shall promote the actual implementation of equal rights for women and men and take steps to eliminate disadvantages that now exist.
(3) No person shall be favoured or disfavoured because of sex, parentage, race, language, homeland and origin, faith, or religious or political opinions. No person shall be disfavoured because of disability. See also Christian Langenfeld, \textit{Artikel 3 Abs 3 GG}, in Maunz and Dürig et al., supra n. 65, vol I, para. 58: Uwe Kischel, \textit{Artikel 3 GG}, in Epping and Hillgruber, supra n. 66, paras 132–35.} As confirmed by the jurisprudence of the German Constitutional Court, Article 3 of the Basic Law also leaves considerable policy space to the legislator to differentiate between foreigners and nationals based on considerations of economic policy and would thus allow protectionist measures to a considerable extent.\footnote{See BVerfGE, at 21, 207, 208–09 (concerning a constitutional complaint by a Delaware incorporated company with seat in New York): Under Art. 19(3) of the Basic Law, the basic rights granted to natural persons are also granted to legal persons, insofar as they are essentially applicable to them. However, this extension of the basic rights only relates to domestic legal persons by means of explicit constitutional provisions. Wording and rationale prohibit any extensive interpretation with respect to foreign legal persons (translation by the present author). Similarly, BVerfGE, at 23, 229, 236; 100, 313, 364.}

Another key provision of the German Constitution that leads to a distinction in constitutional status between foreign and domestic investors is Article 19(3) of the Basic Law. It provides that ‘[t]he basic rights shall also apply to domestic juridical persons to the extent that the nature of such rights permits’. This provision has the effect to limit the protection under any fundamental right granted by the Constitution, including rights that accrue to both foreign and domestic natural persons, such as the right to property, to ‘domestic’ juridical persons. ‘Foreign’ juridical persons, by contrast, are excluded from fundamental right protection under the Basic Law and for this reason can also not have access to the German Constitutional Court to vindicate the right concerned.\footnote{Kischel, supra n. 68, paras 55, 65, 135.} This position has only...
recently been modified by the German Constitutional Court in respect of corporate entities of other EU Member States, which, due to the non-discrimination provisions and the freedom of establishment laid down in EU law, benefit from the Basic Law’s fundamental rights on equal footing and can have recourse to the German Constitutional Court like any other German company.\(^1\) Companies from outside the EU, by contrast, remain excluded from the protection of the Basic Law’s fundamental rights.

Instructive, in the present context, are the reasons why the German Constitution excludes the protection of foreign juridical persons from fundamental rights protection and to reduce it in respect of foreigners who are natural persons. Although this system has been criticized in policy terms, it constitutes a clear and deliberate choice by the constitutional legislator. It is based on the fact that the lack of constitutional protection of foreign legal persons goes along with additional room for foreign policy action for the Federal Republic to achieve the protection of German legal persons abroad through negotiations.

Notably that choice is not principally caused by a desire to take measures that actually differentiate between foreigners and nationals in internal economic regulation. On the contrary, these constitutional limits exist in order to enable the government to effectively negotiate, based on the idea of reciprocity, for better protection of German investors abroad, both in terms of the substantive protections granted to investment post-establishment and as regards investors’ access to foreign markets.\(^2\)

EU law differs from the constitutional situation in Germany in this key aspect: its rules on free movement of capital also accrue to non-EU investors, thus making, as outlined in Part 3, treaty commitments by the EU to access for third-country investors to the internal market de facto worthless as a bargaining chip in EU negotiations of trade and investment agreements. One way to strengthen the EU’s external negotiation power to achieve market access for EU investors in third countries, of course, would be to change Article 63 TFEU and to go back to the pre-Maastricht situation. Alternatively, one could consider whether the scope of Article 63 TFEU should not be re-evaluated in light of the EU’s new external competence for ‘foreign direct investment’ in Article 207(1) TFEU, for example by adapting Council Directive 88/361/EEC to the post-Lisbon situation.

Yet, all of these approaches would, independently of the political difficulties to implement them, send the wrong signal to the world, namely that the EU is

\(^{71}\) See BVerfGE 129, 78, 94 ff.

\(^{72}\) Schill, supra n. 63, at 509, 511 (‘Although this system has been criticized in policy terms, it constitutes a clear and deliberate choice by the constitutional legislator. It is based on the fact that the lack of constitutional protection of foreign legal persons goes along with additional room for foreign policy action for the Federal Republic to achieve the protection of German legal persons abroad through negotiations with other states on the basis of reciprocity’).
backtracking on its commitment to free inward capital flows. These approaches would also be overreaching when the objective is primarily to strengthen the EU’s negotiation position to achieve better access for its investor to foreign markets. For this purpose, it seems sufficient to signal, as the new regulation now does with its introduction of a framework for inward FDI screening, that a commitment in an international trade and investment agreement with the EU to free inward capital flows has value despite, and independently from, the EU’s constitutional promise in Article 63 TFEU to allow free capital inflows from third countries.

The new regulation does exactly that: it signals that the EU and its Member States are in a position to put constraints on access for FDI to the EU market. For this purpose, the regulation re-delegates the authority for inward FDI screening that vests, per the Lisbon Treaty, with the EU, as part of its exclusive competence in respect of the common commercial policy under Article 207(1) TFEU, to the Member States (Article 3(1) of Regulation (EU) 2019/452). It also establishes a mechanism ‘to ensure Union-wide coordination and cooperation on the screening of foreign direct investments likely to affect security or public order’. Information-sharing among Member States and between Member States and the Commission is an important tool in this context (Articles 6–8 of Regulation (EU) 2019/452). The new regulation also ensures that Member States have the authority to screen for constellations where FDI screening is circumvented through structuring of investments through other Member States (Article 3(6) of Regulation (EU) 2019/452).

Finally, the authority the new regulation gives to the Commission to issue opinions addressed to Member States, ‘[w]here the Commission considers that a foreign direct investment is likely to affect projects or programmes of Union interest on grounds of security or public order’ (Article 8(1) of Regulation (EU) 2019/452) is a forceful signal that the EU is able to put effective constraints on inward FDI that threaten its security or public order interests. Even though the Commission’s opinions are not binding on Member States, they allow the Commission to accumulate clout to establish an effective FDI screening mechanism within the EU.

Still, in the reading proposed here, Regulation (EU) 2019/452 does not aim principally at allowing the EU to implement protectionist measures, but rather to negotiate its FDI screening powers away in return for better access for its own investors in third countries on the basis of reciprocity. The very purpose of the Regulation would then be to close the ‘constitutional gap’ that exists between the constitutional objective in Article 21 TEU to achieve further investment liberalization and the EU’s internal market rules that reduce the EU’s power to negotiate effectively for such liberalization with third countries. The Regulation therefore empowers the EU externally by making treaty commitments to access the internal market again

73 See Regulation (EU) 2019/452, seventh recital.
meaningful as a bargaining chip in treaty negotiations with third countries. The Regulation therefore approximates the constitutional setting in the EU with the one that exists, for example, in Germany and puts the EU in a stronger negotiating position in order to fulfil its constitutional mandate to achieve further investment liberalization and to ensure access to third-country markets for its own investors.

5 CONCLUSION

As the preceding analysis has shown, the political branches of the EU, that is, the Commission, the Council, and the European Parliament, have become well aware of the Lisbon Treaty’s constitutional mandate in Article 21 TEU to use the EU’s external relations powers and particularly its common commercial policy to shape globalization according to the constitutional values the EU subscribes to. For international investment relations, the EU’s constitutional mandate entails, inter alia, an attempt to decrease barriers for market access for foreign investors through treaty negotiations with third countries.

As this article has argued, Regulation (EU) 2019/452 on inward FDI screening at EU level has to be seen in this context, namely as an instrument that allows the establishment of a level-playing field between the EU and other major economic powers, such as the United States or China, in order to negotiate, on the basis of reciprocity, an opening of foreign markets for EU investors in return for treaty commitments that give foreign investors access to the EU market. Indeed, reciprocity in international relations is for the EU not only a functional necessity to achieve concessions on the part of third states with which it is negotiating trade and investment agreements. It is also an important factor for becoming an effective global rule-maker and being able to translate its own constitutional values into binding treaty commitments. After all, only if the EU is able to make meaningful commitments under international law, will it be able to achieve the same from third states.

Consequently, as Advocate General (AG) Bot recently stated in his Opinion on Opinion 1/17, ‘reciprocity must be regarded as one of the guiding principles of the EU’s external relations’. 75

Concretely, without the framework for FDI screening Regulation (EU) 2019/452 provides, the EU’s treaty partners have few incentives to grant, on the basis of reciprocity, EU investors access to their markets, given that their own investors, to a considerable extent, already enjoy access to the EU market under the free movement of capital in Article 63 TFEU. In that perspective, Regulation (EU) 2019/452 can be seen as an instrument whose purpose is not only to shield the EU market from certain

75 Ibid., para. 77.
foreign investment on an individual basis, but also to help the EU achieve its constitutional mandate for further investment liberalization through treaty negotiations with third countries.

As the political branches of the EU are actively working to empower the EU to become a successful treaty negotiator, inter alia, by creating the basis for inward FDI screening powers that can then be bargained away, the role of another constitutional actor in the EU, namely the CJEU, is becoming increasingly central for the EU’s success in achieving the Lisbon Treaty’s constitutional mandate relating to the common commercial policy. In fact, the CJEU has developed a line of jurisprudence on the autonomy of EU law that may hamper the role of the EU as an effective rule-maker in international economic law. In order to protect the autonomy of EU law and its exclusive jurisdiction to ensure the uniform interpretation and application of EU law pursuant to Article 19(1) TEU, the Court has, at several occasions, prevented the creation of, respectively the participation of the EU and/or its Member States in, international dispute settlement mechanisms. After casting a negative vote on the dispute settlement mechanisms in the original European Economic Agreement,76 and the European and Community Patents Court,77 the CJEU has more recently opposed the accession of the EU to the European Convention on Human Rights (ECHR) because it found the rules governing its relationship to the European Court of Human Rights (ECtHR) to be incompatible with the autonomy of EU law and its own judicial monopoly.78 Similarly, in its Achmea ruling, the CJEU has used the concept of autonomy of EU law to consider that the provisions in IIAs between Member States for investor-state arbitration are incompatible with EU law.79

Certainly, the relationship between the ECHR and EU law is different from the relationship between EU law and any other international treaty regime, not least because the ECHR plays a special role both in determining general principles of EU law80 and in interpreting the Charter of Fundamental Rights of the European Union (CFR), which is closely connected to the ECHR.81 This may potentially explain the

79 CJEU, Case C-284/16, Achmea, ECLI:EU:C:2018:158.
81 Art. 53 CFR provides:

Nothing in this Charter shall be interpreted as restricting or adversely affecting human rights and fundamental freedoms as recognized, in their respective fields of application, by Union law and international law and by international agreements to which the Union, the Community or all the
specific concerns of the CJEU with the ECtHR. Likewise, the *Achmea* ruling may be specific to the intra-EU context and be concerned more with preventing Member States from withdrawing entire classes of disputes – those between foreign investors and Member States – from the judicial control of EU courts82 than with restricting the possibility of the EU to agree to the inclusion of ISDS provisions in EU IIAs.83 This notwithstanding, there is a tangible danger that the autonomy logic we have seen in the jurisprudence of the Court in respect of the ECtHR and in *Achmea* will also be used to prevent the EU from including ISDS provisions in its free trade and investment agreements.

In fact, in Opinion 1/17, which is currently pending before the Court upon a request by Belgium, the CJEU is asked to consider whether the ISDS mechanism in CETA – the so-called ‘investment court system’, which the EU has developed as its key reform model for IIA dispute settlement in its bilateral investment agreements – is compatible with EU constitutional law, including the concept of autonomy, the principle of equal treatment and non-discrimination laid down in Article 21 CFR, and the guarantee to have access to an independent and impartial tribunal pursuant to Article 47 CFR.84 While AG Bot has come to the conclusion that the ISDS provisions in CETA do not breach EU law, but ‘fall[] entirely within the discretion of the EU institutions to choose to adhere to a well-established international arbitration practice in implementation of the common commercial policy’,85 the outcome of the CJEU’s decision is by no means certain. Were the Court to decide that EU law prevented the EU from including ISDS provisions, such as those found in CETA, in its free trade and investment agreements, this could effectively mean the end of EU involvement in the area of international investment policy making and make it impossible for the EU to reshape and reform this field of international law according to its own constitutional values and mandate. Instead, other powerful economic actors, such as the United States or China, or some other group of emerging actors, could then be in a position to shape the content and institutional infrastructure of international investment law without the EU’s input and potentially in ways that are much less palatable to EU constitutional values than whatever international treaty framework the EU participates in developing.

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83 See on the distinction between ISDS in intra-EU IIAs, on the one hand, and under EU IIAs, on the other hand, in respect of mutual trust, which reigns between Member States, and reciprocity, which reigns between the EU and third countries, Opinion of Advocate General Bot, *Opinion 1/17* (29 Jan. 2019), para. 82.
An understanding of EU constitutional law that would effectively prevent the EU from shaping the law of globalization should be avoided. It would undermine the efforts made at present by the political branches in the EU to reform international investment law and ISDS and to work towards further investment liberalization. It would also pit the judicially developed concept of autonomy of EU law against other norms of EU constitutional law laid down expressly in the EU treaties, in particular Article 21 TEU. The CJEU would be well advised not to develop the autonomy of EU law into an absolute barrier that would effectively destroy the EU’s power as an active and effective rule-shaper in international economic law. Instead, the CJEU should support the EU in using its external relations and treaty negotiation powers to shape globalization according to the EU’s core constitutional standards of promoting and protecting democracy, the rule of law, human rights, and sustainable development. To achieve this, policy space in the EU’s external economic relations is needed.