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Screening for Security: The Defence Sector as a Gateway to Broader Economic Control**

ABSTRACT: This paper explores certain aspects of defence industrial protectionism, and draws parallels with investment screening, as one of the major tools used to maintain economic security. Investment screening has been used quite often in the case of takeovers in the defence sector. Investments in this area, coming from either strategic partners or adversaries, have previously been blocked in several jurisdictions. While this was viewed as normal, the expansion of this treatment to other areas of the economy is a more recent development. Economic security, as a dimension of national security often takes precedence over liberal market principles. Several economic activities are now subject to screening, resulting in further state involvement in the economy, under the guise of the protection of economic security.

KEYWORDS: defence industry, national security, economic security, investment screening, broadening terms.

1. Introductory remarks

National security is a broad concept encompassing numerous dimensions and components. The international economic order, largely built upon neoliberal economic principles, in a period of low geopolitical competition, permits national security protection to prevail over free-market economics only in exceptional circumstances. While this rule remains in place, the number of exceptional circumstances triggering the national security exception appears to be increasing daily. Economic security, a dimension of

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national security that has been gaining greater attention, is increasingly used to justify state intervention in the economy on an unprecedented scale. This shift is driven, in part, by the expansion of economic areas considered *strategic*, as security is being addressed in a more complex and comprehensive manner. While military and defence-related economic activities have traditionally been clear-cut cases for national security protection, a growing number of economic sectors are now associated with this seemingly narrow domain. There has been a notable rise in defence-related technologies, an increase in technologies with *considerable dual-use potential*, and a broader recognition of sectors with strategic significance, ranging from high technology to academic research.

The heightened focus on security is relatively recent, as international agreements and domestic laws have historically prioritised economic benefits through market liberalisation and free trade. Even when certain countries introduced restrictions on or reviews of foreign investment in the 1970s, the primary objective appeared to be the enhancement of potential economic benefits. Such regulations were criticised at the time for granting governments 'wide discretionary power',[1] particularly because some states required foreign investment to align with the *national interest*, a term that was often defined with reference to economic considerations.[2] Nowadays, the situation is more explicit. From the expansion of the functions of the Committee on Foreign Investment in the United States (CFIUS),[3] to the European Union's (EU) introduction of national security reviews of foreign investment through regulation,[4]—which has prompted the adoption of various investment review mechanisms by its Member States—the *collective West* is strengthening its *geoeconomic competition* toolkit. A key element of this strategy is the growing emphasis on economic security as a fundamental component of national security, including the imperative to safeguard certain *strategic interests*.

Focusing principally on the EU, this paper explores the intersection between defence industrial protectionism—often characterised by state intervention justified on national security grounds—and the extension of

[1] For example, in Canada, where it was also noted that wide discretion was actually needed for the system to be sufficiently flexible. See Cranston, 1973, p. 360.
[2] Ibid. pp. 361–362.
[3] Via the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018.
[4] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I, 21.3.2019, pp. 1–14.

such intervention to other areas of the economy. A case can be made for such an approach, as economic sectors beyond traditional defence are increasingly being incorporated into the broader concept of national security, effectively receiving similar treatment to that of the defence industry. The next section explores the expansion of the national security concept, which now includes *economic security*, as well as *food*, *data*, and *research security*. This broadening of scope is likely to extend the security exception to additional sectors of the economy, with potential implications for the existing framework of international economic law. Insights gained from the application of the security exception in the defence industry may provide valuable lessons in this regard.

The term *defence industry* should be interpreted broadly, as many companies, in pursuit of profitability, operate in both the military and civilian domains.[5] Innovations emerging from the civilian sector now play an essential role in military equipment, and this interconnection has significant consequences for the further securitisation of other economic sectors. The third section of this paper explores these implications. The fourth section provides a brief analysis of investment screening—one of the most essential tools for ensuring economic security and preventing undesirable investments in the current geopolitical competition. The fifth section addresses the challenges of adapting to the economic security paradigm and presents two contrasting cases in which investment screening was applied to safeguard companies deemed strategic by the state. The final section offers the author's concluding remarks.

2. National security: Broadening

Although the national security exception has come under scrutiny in international dispute settlement, states continue to incorporate it into new mechanisms of economic control, often with limited judicial oversight.

The national security exception is not always compatible with the institutions of international economic law. In the rules-based system of international trade under the World Trade Organization (WTO), the *security exception*—embedded in Article XXI GATT, Article XIV GATS, and Article 73 TRIPS—was originally part of a *gentlemen's agreement*, intended for use only in truly exceptional circumstances.[6] Controversy only

[5] See also, Eisenhut, 2021, p. 278.
[6] Nagy, 2021, p. 49.

recently arose in relation to tariff increases imposed by the first Trump administration on steel and aluminium products (Section 232 tariffs), which were challenged before a WTO dispute settlement panel. The panel found that the measures did not comply with the security exception in Article XXI(b)(iii) of the GATT[7] invoked by the United States, as there was no evidence that they were 'taken in time of war or other emergency in international relations.' It may nevertheless be justified for a state to invoke Article XXI(b)(ii) of the GATT[8] to implement a degree of protectionism aimed at preserving the production capacity of certain industries crucial for maintaining domestic defence capabilities.[9] Such measures would be underpinned by the necessity of securing the supply chain for the production of certain defence materiel. Arguably, such measures would be upheld if taken in good faith, given that security exceptions are not entirely judicialized under the multilateral trading system.[10] Much depends on whether protective measures are genuinely taken in good faith, as a vast array of goods can be linked to defence needs—'from shoes to watches, radios to beef production'.[11] Consequently, if the national security exception is not appropriately curbed, its reach may be overly extended, potentially undermining the multilateral trading system. Similar concerns arise in the field of foreign direct investment (FDI) control.

Highlighting this crucial development, scholars have warned that the extensive use of economic security considerations in justifying national security exceptions could lead to their use as a protectionist tool 'on everything from steel and aluminium to tents'.[12] Judicial intervention aimed at censoring actions of the executive branch underpinned by national security considerations is unlikely to be particularly assertive. In the context of investments, an *ex post* judicial review of a national security screening

[7] Which reads as follows: „Nothing in this Agreement shall be construed to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests taken in time of war or other emergency in international relations".

[8] Which reads as follows: „Nothing in this Agreement shall be construed to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment".

[9] As suggested in Nagy, 2021, p. 56.

[10] Ibid.

[11] Jackson, Davey, and Sykes, 2013, pp. 1199–1203 *apud* Nagy, 2021, p. 52.

[12] Roberts, Choer Moraes and Ferguson, 2019, p. 665.

decision may offer slightly more recourse than the WTO dispute settlement panel's decision. An investment arbitration case brought against an adverse screening decision—such as one resulting in the unwinding of an investment—may ultimately succeed. However, in the meantime, the investment remains obstructed. The immediate negative effects of investment screening are difficult to fully remedy. Strong regional economic integration organisations, such as the EU provide an additional layer of judicial scrutiny, which may override certain decisions made by national authorities and courts. However, such interventions may come too late for investors.[13] Investment screening is not only a tool that can be applied swiftly, but is also one with quite a wide scope, allowing states a wide margin of appreciation for its application. In addition, there are other, more novel areas that are viewed through a *security lens.*

Data security has emerged as a particularly significant frontier of national security, with certain investors being required to divest from companies due to concerns about the nature of consumer data collected by their applications.[14] Arguments related to data security have also been cited in policy moves against electric vehicles from China.[15] Data security concerns were briefly referenced in the US Trade Representative's 2024 report to Congress.[16] Meanwhile, Chinese electric vehicles have been subjected to high tariffs in the United States, the EU, and, more recently, Canada. Although data security was not a major focus of the report, its mention in the trade context raises the question of whether tariffs are truly an effective tool for protecting national security: in the mentioned context tariffs do not prevent the importation of the vehicles but merely make them more expensive. It is possible that high tariffs and data security concerns signal future regulatory measures aimed at a complete ban on Chinese electric vehicle (EV) imports.

Another emerging concern is food security, alongside the related concept of food sovereignty. These have been invoked as justifications for prohibiting foreign takeovers, even when the acquiring companies originate

[13] Kovács, 2024, p. 224.
[14] CFIUS forcing divestiture from *Grindr* and *PatientsLikeMe*, or more recently from *TikTok*.
[15] In the US: Daly, 2024. Also in the UK: Churchill, 2024.
[16] Executive Office of the President of the United States, 2024, p. II.

from allied countries.[17] Similarly, academic research and collaborations between educational institutions are now regarded as integral to national security, with recent policy documents referencing *knowledge security* or *research security*.[18] The potential security threats associated with knowledge security tend to centre on research and development projects with defence applications, particularly in engineering and material sciences. Innovation remains a cornerstone of military superiority. However, the role of the social sciences has not been entirely discounted. While no precise security threat has yet been identified in this field, collaborative research between European and Chinese academic institutions has been highlighted in reports on knowledge security.[19]

As the geopolitical competition intensifies, in the geopolitical turn, understanding the *security exception* in its various dimensions becomes increasingly pertinent. The defence industry, having consistently benefitted from protective measures, may offer insights into how this exception will be applied. This is particularly relevant for decision-makers seeking to ensure that the use of this exception is neither censured by domestic or international judicial bodies nor rendered prohibitively costly due to damages incurred.

3. The *special treatment* of the defence sector

The defence industry—including defence equipment procurement, investment, and trade—has long operated under a distinct regulatory framework that allows for both protection, by preventing the unwanted actors' involvement, and protectionism, through the application of industrial policy and preferential treatment. Even EU treaties have been drafted to accommodate such special treatment, requiring that subsequent rules and regulations align with these treaty provisions. As demonstrated herein, various controls may be imposed to prevent undesirable takeovers, mergers, and acquisitions, with investment screening being just one of them.

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[17] See the prohibition of takeover of French Carrefour by Canadian Couche-Tard, citing *food security* and *food sovereignty*, Barbaglia and Barzic, 2021. See also the prohibition by the Italian state of purchase of seed producer Verisem by Chinese-owned Syngenta.

[18] Commission, 2024a. Executive Office of the President of the United States, 2024. Commission, 2022.

[19] Navigating Challenges and Risks in Sino-European Academic Collaborations, Datenna, no date.

One of the broader exemptions from EU law is provided in Article 346(1)(b) TFEU, which states that 'any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material'. However, the application of this exemption is not without constraints. The European Commission has published an interpretative communication underscoring that Member States must 'provide, at the Commission's request, the necessary information and prove that exemption is necessary for the protection of their essential security interests.'[20] Furthermore, established CJEU case law mandates that any exemption must adhere to the principle of proportionality.

The Schiebel case before the CJEU,[21] examined a particularly notable rule implemented by a Member State, which stipulated that any business engaged in the trade of military weapons and munitions, or in brokering such transactions, must have Austrian nationals as members of their statutory representation bodies or as their managing partner.[22] In scrutinising these rules, the Court clarified that any derogation based on Article 346(1)(b) must be demonstrably necessary and proportionate to safeguarding a Member State's essential security interests.[23]

In the field of defence procurement, regulatory efforts to establish a European defence equipment market (EDEM), particularly through the Defence Procurement Directive,[24] have failed to significantly curtail preferential procurement practices or eliminate offset arrangements. A 2021 report commissioned by the European Parliament (EP) highlighted that Member States had introduced legislation making it 'difficult to assess whether the Article 346 exception has been used for justified reasons of protection of national essential security interests, or just a way to limit the application of [the] Directive'.[25] By asserting control over defence

[20] Commission, 2006, p. 8.
[21] Case C-474/12, *Schiebel Aircraft GmbH v Bundesminister für Wirtschaft, Familie und Jugend*, 4 September 2014.
[22] Id., para. 6.
[23] Id., para. 37, 39.
[24] Consolidated text: Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC, OJ L 216 20 August 2009, p. 76.
[25] Schwab, 2021, p. 4/25.

acquisitions, Member States have leveraged procurement to strengthen their defence technological and industrial base, often by requiring offsets.

In the area of mergers and competition, Article 21(4) of the EU Merger Regulation[26] grants Member States jurisdiction over mergers that meet the Union dimension where the protection of legitimate interests—such as public security or specific public concerns—is warranted. This provision is frequently employed alongside Article 346 TFEU, with the latter typically analysed first.[27] Combining the two, and considering the opacity surrounding the use of the exemption under Article 346 TFEU, Member States may effectively thwart unwanted investments.

The Article 346 exemption may not suffice in certain circumstances, particularly as it is only triggered in 'exceptional and clearly defined cases'.[28] With regard to dual-use goods, a category that continues to expand,[29] these are not even covered by the exemption under Article 346(1)(b). This is due to the explicit provision in the second part of this paragraph, which states that measures under it 'shall not adversely affect the conditions of competition in the internal market regarding products not intended for *specifically* military purposes [emphasis added]'. Established case law holds that such derogations 'do not lend themselves to a wide interpretation'.[30] This is further supported by jurisprudence[31] as it pertains to dual-use goods. The rules governing dual-use goods seem clear in theory: in relation to civilian use, these goods are subject to general EU rules, while national security matters fall under Member States' rules, in line with Article 346(1)(b) TFEU.[32] However, discerning the *intended* use of dual-use goods is complex.

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[26] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24, 29 January 2004, pp. 1–22.

[27] See Eisenhut, 2021, pp. 268–269, also for examples of cases, such as the takeover of Next AST by Altran Group, or the takeover of Atlas Elektronik by Thales Group, and others.

[28] C-414/97, *Commission of the European Communities v Kingdom of Spain*, 16 September 1999, para. 21.

[29] Commission Delegated Regulation (EU) 2023/2616 of 15 September 2023 amending Regulation (EU) 2021/821 of the European Parliament and of the Council as regards the list of dual-use items, published in OJ L 15 December 2023.

[30] C-414/97, *Commission of the European Communities v Kingdom of Spain*, 16 September 1999, para. 21.

[31] Case T-26/01, *Fiocchi munizioni SpA v Commission of the European Communities*, 30 September 2003, para. 61, a*pud* Trybus, 2014, pp. 94–95.

[32] Craig and De Búrca, 2015, p. 347.

While it is easy to ascertain the use of semiconductors ordered by a company active in the defence industry, it is less straightforward when goods intended for civilian use are resold for military purposes.[33] Efforts are continually made to weed out economic actors involved in such practices and alert sellers to ensure compliance with export restrictions, thereby preventing unauthorised exports, reexports, or transfers.[34] Detecting investment activity in dual-use goods may be easier than tracking the final destination of a product. For example, identifying a company producing dual-use goods targeted for takeover by a civilian company with strong ties to an adversary nation's military may arguably be simpler than tracing a product sold to a foreign buyer. While dual-use goods are regulated at the EU level, the Regulation in question does not address investments, takeovers, mergers, or acquisitions.[35] To address this gap, the Commission strongly recommends that Member States adopt an investment screening mechanism focused on national security and public order to prevent unwanted capital flows into the dual-use sector and beyond.

The FDI Screening Regulation provides an exception to the free flow of capital for national security and public order reasons. Although this exception may seem wide and discretionary, it must be exercised under scrutiny. National security exceptions must be invoked within the limits of justifiability. Accordingly, EU Member States have both the right and the obligation to protect against investments that pose risks to themselves or the single market. The Regulation ensures EU-wide coordination and cooperation, as set out in Recital 7 and Article 1(2), while preserving Member States' responsibility for protecting their national security as per Article 4(2) TEU and their essential security interests under Article 346 TFEU.

The use of this national security exemption via investment screening must be justifiable in accordance with rule of law principles. As Recital 4 of

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[33] An example is that of household appliances ending up as spare parts for military purposes, as suggested by the President of the European Commission Ursula von der Leyen at the Tallinn Digital Summit, and debunked by Tegler, 2023, *Is Russia really buying home appliances to harvest computer chips for Ukraine-bound weapons systems?* Forbes, 20 January 2023; and by Piedr, 2023.

[34] See Commission, 2023, Guidance for EU operators; or the Guidance issued by the Bureau of Industry & Security on 10 July 2024.

[35] See Council Regulation (EC) No 428/2009 of 5 May 2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items (recast), OJ L134, 29 May 2009.

the Regulation states, it 'is without prejudice to the right of Member States to derogate from the free movement of capital as provided for in point (b) of Article 65(1) TFEU'. Under this, and in accordance with EU law, a restriction is permissible 'only if there is a genuine and sufficiently serious threat to a fundamental interest of society'.[36] Recital 7 of the Regulation further stipulates that screening mechanisms must ensure legal certainty. Nevertheless, when evaluating national security decisions made by the executive branch, courts are likely to tread carefully. As stipulated by the Regulation, investors subject to screening obligations must be provided with an avenue for recourse against screening decisions.[37] The efficiency of such recourse will depend on numerous factors, with the political context playing an important role in the courts' willingness to challenge such decisions. When reviewing measures concerning national security economic policy, courts generally exercise considerable deference.[38] This, coupled with the opacity of the screening procedure, is already highly likely to deter certain investors.

With respect to the key focal points of investment screening mechanisms, the defence industry is *primus inter pares*. Global competition is intensifying, and tools such as export controls and investment screening are increasingly deployed to prevent adversaries from acquiring Western technologies for purposes such as enhancing their military capabilities. The potential military threat is often cited as a principal reason for the introduction of (previously decoupling, nowadays) de-risking policies.[39] This positions defence industrial companies at the forefront, as primary targets of these tools. However, including defence-related industries within the scope of investment screening is somewhat perplexing, as many states view defence companies primarily 'as part of their national security domain, closely linked to their defence and security policy, and only secondarily as an area of economic policy in a certain industry sector'.[40] Companies in this area have largely benefitted from state protection(ism).

[36] Case C-54/99, *Association Eglise de scientologie de Paris és Scientology International Reserves Trust kontra Premier minister*, 14 March 2000, para. 17, *apud* Hindelang, Moberg, 2020, pp. 1451–1452.
[37] Article 3(5) FDI Screening Regulation.
[38] Craig and De Búrca, 2015, p. 552.
[39] Josephs, 2024.
[40] Eisenhut, 2021, p. 266.

Criticism of EU defence industrial protectionism has come not only from NATO allies but also from major industry players within the EU.[41] Nonetheless, the fate of defence industrial companies has rarely been left to the free-market principles applied to other sectors of the economy. Preserving a certain degree of armament autonomy through maintaining some defence industrial production capacity and the ability for autochthonous production to ensure security of supply is crucial to a country's security strategy. Considering the de-industrialisation that occurred in East-Central Europe after the fall of communism, affecting all areas of the economy, protectionism favouring local defence industrial players has been vital to preserve their capacity for autochthonous production. Even so, evidence suggests that the EU's eastward expansion has exacerbated the East-West imbalance in the defence industrial landscape.[42]

In the context of the ongoing competition for technological supremacy, national security exceptions in international trade and investment may appear as mere tools of protectionism. However, this is only one interpretation. A closer examination of the structure of the defence industry reveals a more nuanced view, as currently large portions of the defence industry are commercially driven. This is a consequence of the fact that much technological innovation is commercially driven, from innovation in space technology, to the production of high technology components. Civilian technology and components produced in civilian industries have increasingly been used by defence companies. Conversely, to remain viable, defence companies have at times had to diversify their markets, thus producing for both civilian and defence sectors. The integration of civilian products into the defence supply chain introduces certain vulnerabilities, which regulators are now addressing. Security of supply is of paramount importance in the defence sector, and exposure to supply chain vulnerabilities can prove fatal. As a consequence of the integration of civilian technologies into military equipment production, further areas of the economy are now susceptible of being labelled as strategic and are now covered by new protective legal measures.

To ensure that other areas of the economy, especially companies in the expanding *dual-use* sector, receive adequate protection, investment screening has become a vital policy tool. The protection previously

[41] Pfeifer and Foy, 2024; Mehta, 2018.
[42] Briani et al., 2013, p. 34.

extended to undertakings in the defence industry may now be applied to undertakings in a broad range of adjacent economic sectors. As observed in a research note by the OECD, technological breakthroughs have expanded the scope of investment review mechanisms to encompass 'non-traditional sectors' in addition to traditional ones such as defence.[43] Additionally, as part of discussions on various dimensions of national security, states may also consider non-defence sectors as strategic and therefore subject to screening mechanisms. In the EU at least, the use of investment screening must also be justified, and the measures enacted must be proportional to the perceived threat.

4. Investment screening as a quintessential instrument of geoeconomic competition

Investment screening is a relatively novel tool through which the national security exception has been extended to new areas of the economy. In what could be called a rapid shift in attitude of the European Commission the EU adopted a more cautious approach to incoming FDI starting in 2017. At the request of the French, German, and Italian governments in February 2017, the Commission, after consulting with the EP, proposed a Regulation on the screening of FDI flowing into the EU. The proposal was adopted in March 2019, and the Regulation entered into force in October 2020.[44]

The evolution of the EU's approach to investment screening—amidst the repeated affirmation by then-Commission President Jean-Paul Juncker that 'we are not naïve free traders'[45]—has been well documented.[46] The FDI Screening Regulation, designed to encourage and coordinate the screening of FDI within the EU, is based on the Common Commercial Policy, Article 207(1) TFEU. Investment screening aims to block or unwind foreign investment in certain economic sectors based on national security and public order considerations. As a result of the screening process, an investment may be prohibited, allowed under certain conditions, or allowed unconditionally. However, the very existence of this mechanism, along with

[43] OECD, 2024, para. 8.
[44] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I, 21 March 2019, pp. 1–14.
[45] Commission, 2017.
[46] Hindelang and Moberg, 2020, pp. 1427–1435.

the obligation to undergo screening, may in itself discourage certain economic actors from proceeding with their investments.[47]

As it moves towards becoming an established component of the EU's regulatory framework, the Commission is preparing to shift gears on FDI screening. In early 2024, the Commission published a package of five proposals aimed at strengthening the EU's economic security 'at a time of growing geopolitical tensions and profound technological shifts.'[48] These proposals target areas such as export controls, support for research and development involving technologies with dual-use potential, enhancing research security, as well as investment screening. Regarding the latter, two key dimensions must be noted: first, the strengthening of the existing system for investments coming into the EU, and second, the exploration of a regulatory framework for screening outbound investment.

The screening of investments into the EU has been part of the regulatory landscape for several years and is a factor that foreign investors must consider. The FDI Screening Regulation provides a blueprint for implementing national FDI screening mechanisms, offering guidance on key aspects such as time limits for the screening process, the possibility of judicial review, and the economic areas subject to scrutiny. It also establishes specific rules governing cooperation and information-sharing amongst Member States and with the Commission. While the Regulation does not impose an obligation to legislate, the document evaluating its impact presents arguments in favour of making screening mechanisms mandatory for all Member States.[49] Indeed, an investment established in any one Member State constitutes an investment within the EU, meaning some of its potential consequences are borne by all within the single market. This constitutes a robust argument for cooperation between Member States and the Commission regarding certain investments. However, such cooperation can easily be turned into a two-way avenue, as influence may also be exerted on Member States to adopt a particular stance on specific investments. This process is embedded within a screening procedure and cooperation framework that is, by default, subject to strict confidentiality. As a consequence, not only is judicial oversight limited, but broader mechanisms of public accountability—essential in a democratic society—may also be significantly curtailed or rendered opaque.

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[47] As also noted in World Investment Report, 2021, p. 114.
[48] Commission, 2024a.
[49] Commission, 2024b, Section 3.2., p. 7.

The EU FDI Screening Regulation broadly identifies several areas of interest, including, *inter alia*, critical infrastructure in aerospace and defence, as well as critical technologies and dual-use items such as artificial intelligence, robotics, semiconductors, aerospace, defence, and nuclear technologies.[50] The proposal for a new FDI screening regulation[51] expands the economic areas of interest in Annex II to include, *inter alia*, dual-use items, military technology and equipment, advanced semiconductors, quantum technologies, space and propulsion technologies, robotics, and autonomous systems. Annex II provides further guidance on these areas, while Annex I enumerates several EU funding programmes that require mandatory screening of investments in participating companies, including the European Defence Fund. Investments reviewed under Annex I must be notified to the cooperation mechanism between the Commission and Member States. Additionally, the proposed Regulation explicitly allows Member States to extend screening to economic sectors of particular importance to their national security and public order. Accordingly, Member States may include various economic activities within their screening mechanisms. Although screening decisions may be subject to judicial review—ultimately by the Court of Justice of the European Union (CJEU)—their immediate application may effectively thwart an investment.

Since its implementation, EU Member States have accumulated some experience with investment screening, and judicial practice has contributed to a clearer understanding of the Regulation's scope and application.[52] Such judicial interpretation is valuable, as challenges in defining the Regulation's scope of application were revealed in the opposite conclusions reached in the judgment of the CJEU,[53] and the opinion of Advocate General Ćapeta[54] that preceded it.[55] Judicial proceedings have also revealed in part how the mechanism is used, especially in cases of misuse.

[50] Article 4(1)(a)–(b) of the Regulation.
[51] Commission, 2024c.
[52] Kovács, 2024; Kovács, 2023.
[53] C-106/22, *Xella Magyarország Építőanyagipari Kft. v Innovációs és Technológiai Miniszter*, 13 July 2023.
[54] Opinion of Advocate General Ćapeta delivered on 30 March 2023 in Case C-106/22 Xella Magyarország Építőanyagipari Kft. v Innovációs és Technológiai Miniszter.
[55] See also Di Benedetto, 2023. The proposed reform of the Regulation extends its applicability to *indirect* acquisition of control over an EU target, in line with many national screening regimes that already cover such cases.

In this new era of great power rivalry, investment screening serves as an essential, gap-filling instrument for mitigating security risks posed by unencumbered FDI. Its use may prevent systemic rivals from gaining control over sensitive emerging technologies or critical infrastructure. Asymmetries in national economic openness have exposed not only economic but also security vulnerabilities. European companies being 'acquired as part of other countries' strategic industrial policies' is rightly perceived as a major threat.[56] The targeting of companies operating in strategically sensitive areas, including dual-use items, was among the key arguments for implementing FDI screening mechanisms.[57] However, what constitutes a *strategically sensitive* area is often a political decision, which also influences screening outcomes.[58] This fact may place certain screening decisions on a collision course with rule of law principles.

5. Adjustment to the economic security paradigm

As an increasing number of economic areas receive the special attention previously reserved for the defence industry, some of the principles and legal frameworks applied to the defence sector are now being transposed to other sectors. This shift reflects evolving perceptions of security risks. On one hand, there is a heightened awareness of security threats, exacerbated by Russia's aggression against Ukraine, which has underscored hard defence risks. On the other hand, broader security considerations, such as economic security, are rising on national agendas. The principal objective of economic security measures is to mitigate dependencies—that is, to equip states with tools for intervention to prevent overreliance on particular supply chains and reduce economic vulnerabilities.

Notably, language traditionally associated with defence economic management is now being used to articulate other economic desiderata. Some of the rhetoric underpinning these newfound ambitions for *protection* has long justified *protectionism* in military procurement and the development of the domestic defence technological and industrial base. Terms such as militarily consequential goods, potential for dual-use, and security of supply are only some of the terms that more frequently appear in

[56] Proposals for ensuring an improved level playing field in trade and investment, Eckpunktepapier, 21 February 2017.
[57] Hindelang and Moberg, 2020, p. 1430.
[58] As also noted by Vig, 2020, p. 17.

discussions concerning economic activities and products previously outside the realm of the defence sector. Given that many civilian technologies are now assessed through the lens of their *potential for dual-use*, the adoption of defence-related terminology may be considered appropriate. Consequently, in an international economic paradigm, where non-discrimination was once paramount, there is now a discernible shift towards prioritising domestic or *like-minded economies* to preserve technological and strategic independence.[59]

Navigating this evolving landscape presents significant challenges for legal practitioners—and even greater ones for businesses. As regulatory lists and designations expand, with more economic actors and products subject to sanctions and export controls, the prevailing trend is rather one of overcompliance. The regulatory complexity discourages companies from engaging with businesses closely linked to those affected by export controls and sanctions.[60] While these instruments may deter some investors, investment screening, by comparison, appears as an instrument which may be used with surgical precision.

Within the EU, Member States are solely responsible for their security needs, often excluding the defence industry from standard market regulations and free-market logic. Ensuring security of supply entails various controls that effectively normalise protectionism in this sector.[61] These measures range from preferences in defence procurement and the use of offset requirements, to outright prohibitions on unwanted takeovers. As economic security is becoming part and parcel of foreign and economic affairs, similar protective measures will likely extend to other sectors deemed critical for maintaining economic security.

Legal instruments designed to uphold economic security must be effective in countering adversaries' attempts to impose economic coercion while remaining rooted in a rule of law system. Given this objective, it is understandable why such instruments must accord states a wider margin of discretion—particularly when the aim is as abstract as building resilience against economic disruptions. Their compatibility with rule of law principles remains an open question, as it may ultimately depend on the extent to which states feel compelled to invoke security exceptions in response to emerging threats.

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[59] See also Eisenhut, 2021, p. 272.
[60] As was noted by Crosignani et al., 2024, pp. 20–23.
[61] This has been the case for decades, as demonstrated by Commission, 2006.

The much-criticised *margin of discretion* is wide both in terms of states' discretion in determining their security interests and in relation to the economic activities that the screening mechanism may be applied to. Regarding trigger mechanisms for screening, the use of broadly defined criteria for review, such as *defence and security*, is noteworthy.[62] Additionally, the expansion of the list of economic activities to which screening criteria apply must also be noted. Conversely, some have criticised investment screening mechanisms for having too narrowly defined a scope. One screening authority concluded that it did not have jurisdiction over a particular acquisition of a company owning technology that could also have military applications. In another case, the same authority chose not to scrutinise the acquisition of a company active in the development of 6G technology and semiconductors for radar systems.[63]

Such criticism is commensurate with commentators' mention of *clean energy* as part of *dual-use*, alongside 5G, quantum computing, and artificial intelligence.[64] Defence-related industries are often referred to as *sensitive* or *critical*, and are subject to lower thresholds triggering screening.[65] Crucial factors triggering screening include the sensitivity of the economic activity targeted by the investment, the origin and economic activities of the investor, and the level of control or influence sought by the investor. Sensitivities may thus be triggered by the target company's products having defence potential, or by the investor's ties to a country's military. While it is quite clear that investment screening is a tool aimed principally at acquisitions made by companies linked to adversaries, the sensitive nature of the investment may result in the prohibition of investments made by companies from friendly countries.

The expansion of the list of sensitive sectors, especially in light of what is now considered dual-use or strategic, is striking. These factors together result in more investment control, and potentially more transactions

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[62] A policy brief observing trends on investment screening in G20 countries that have them, takes note of criteria such as: national security, public order, national interest, public security, national defence, essential interests of the state, defence interests, public safety, public health, smooth operation of the economy, essential security interests, etc. See Mildner and Schmucker, 2021, pp. 5–9.

[63] See the acquisition of Nowi by Nexperia, and the acquisition of Ampleon by „a Chinese investor", as reported by Linklaters, 2024.

[64] Tyson and Zysman, 2024.

[65] See also Country Notes published by the CELIS Institute, [Online]. Available at https://www.celis.institute/resources/#Countryreports (Accessed: 12 July 2024).

being thwarted. A notable example in this regard is the acquisition of the German satellite and radar technology firm IMST by the Chinese defence company Addsino Co. Ltd. Several reasons led the state to oppose the acquisition, as reported in the press: the acquirer was a subsidiary of the Chinese state-owned entity China Aerospace and Industry Group (CASIC), the target company provided components to the German military, and the target company benefited from state funding. However, according to media reports, the company's owners were very dissatisfied with the decision of the competent authority to block the acquisition, arguing that their contribution was to a particular satellite of civilian use, which was only later used also by the Bundeswehr.[66]

Despite the company owners' arguments that theirs was a strictly civilian technology firm, the competent ministry still considered the acquisition too sensitive to approve. While it may be argued that the research and development conducted with state funding should preclude such a sale, all such research was published and publicly accessible, as noted by ISMT owners, who also mentioned that the company was already part-owned by Chinese partners. The ministry's decision was contested in court, but the case was later withdrawn.[67] The fact that the acquisition was blocked even though the target company considered itself *civilian*, and noted that its technology was already freely available in research publications, reinforces in a sense that politics play a major role in screening decisions. More to this point: the owners were planning to sell their stake to a close business associate who was already a part-owner and presumably had access to all the technology developed by the target company.

In France, the state used investment screening measures to block the acquisition of Photonis, a high-technology company producing light intensification equipment, used in both nuclear and military technology. The bidder was Teledyne, a US-based company.[68] In this case, the French government chose to assert its strategic interests, even in relation to a company from a strategic partner.[69] Part of the rationale for the ban was to

[66] Neßhöver and Slodczyk, 2020.
[67] Von Rummel and Stein, 2024.
[68] Bernard, 2020. A similar case was the vetoing of the takeover of French companies Segault and Velan SAS by American group Flowserve, see: Leali and De Villepin, 2023.
[69] A similar situation occurred in the proposed acquisition of the Italian company Next AST by the French group Altran, which was blocked by the Italian government in view of the strategic activities of the company in the Italian defence sector. See Senato della Repubblica, 2018, p. 11.

'prevent Photonis from ending up subject to the US International Traffic in Arms Regulations, thereby restricting its future export activity.'[70] This case highlights another important factor considered by states during investment screening: export controls, particularly in the expanding domain of defence-related and dual-use technologies.[71] Screening in such cases appears increasingly complex, with more factors taken into account during the attempted takeover of a company in a strategic domain.

The above cases are excellent examples of the variation in state interest. The readiness of the state to block the takeover of a company partly owned by the acquirer is noteworthy. In this case, it is questionable how effective the protective measure actually was, considering that the acquirer, a Chinese company with a minority shareholding, had access to the company's technologies. The state essentially insisted that the company's technology was dual-use. By contrast, in two other cases where dual-use could have easily been argued, the state chose not to block the takeovers. Finally, there was the blocking of a takeover by a company from a partner country, justified by the need to protect state strategic interests, maintain control over a particular technology, and prevent it from becoming subject to an ally's security measures, specifically export controls. These cases demonstrate the variation in state interest and buttress the view that investment screening is a tool to be applied with surgical precision.

6. Concluding remarks

The numerous dimensions of national security that have recently gained prominence, among which economic security stands out, also require new tools for their protection. The defence sector has been subject to special treatment within the EU, with carve-outs in its legal system allowing Member States to exercise a certain level of protectionism. The use of these carve-outs has also shown their limits. Investment screening is a tool that addresses some of these gaps, facilitating state intervention in economic activities that the state considers to be strategic. It thus helps to prevent dual-use or critical technologies from coming under the control of adversaries.

In the wider scheme of things, the introduction of these new instruments to protect economic security may restrict market efficiency and

[70] Bet-Mansour, 2023.
[71] A point also highlighted in Viski, 2024, pp. 10–11.

foster a new economic paradigm inspired by the economic logic traditionally reserved for the defence sector, focusing on security of supply and the safeguarding of sensitive technologies. This begs further questions: what will happen to a target company, from which the owners wish to exit, but where the state does not agree with the proposed investor taking over? Should the state step in to take over such a company? Can anyone be forced to maintain ownership of a business? These are questions that merit further attention and suggest a likely conclusion: protection begets protectionism. Protecting national security may ultimately force states into actions that would come under the label of economic protectionism.

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