*Review scientific paper*

# FROM INTEGRATION TO GEOPOLITISATION OF THE EUROPEAN INTERNAL MARKET

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## Abstract

This paper analyses the recent developments in the European Union's approach of foreign investments. We examine how the European economic model has progressively shifted from the market integration towards market protection from negative geopolitical influences. The 2008 crisis and global competition have revealed vulnerabilities in the internal market, forcing the EU to reexamine its traditional market openness to the foreign investments. The 2019 Regulation on screening of foreign direct investments was the first attempt to build a common protection system, but its recommendation only role, in combination with Xella judgement, have opened room for circumvention of the protection system through subsidiary formations in other Member States and multi-layered "Matryoshka" ownership structures.

The new reform which will be implemented this year is aimed at eliminating those loopholes through broadening the very definition of foreign investment, introducing compulsory verification mechanisms in all Member States as well as harmonisation of the supervised sectors. At the same time, we discover the new grey zones: large greenfield projects, convertible loans and talent-based acquisitions. Such developments show the difficulty for the EU authorities to efficiently monitor the adaptability of the investment strategies to new legal obstacles, making such monitoring, in turn, rapidly obsolete. The conclusion of this analysis is that the EU tends to abandon its former liberal tradition and, acting as a geopolitical actor, tries to elaborate instead a shield around its internal market. However, such strategy only partially meets the sophistication tendency of modern foreign investment.

***Keywords:*** *Foreign Direct Investment; EU Economic security; Xella case; Matryoshka structures; FDI Screening reform*

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## INTRODUCTION

The European Union (EU) has adopted significant policy changes to foreign direct investment, which came into effect gradually after the 2008 liberal framework. Prior to 2008, the EU considered foreign capital as an economic recovery tool during the "Europe for Sale" period, which led the EU to prioritise the capital inflow over the strategic asset ownership protection (Bujak, 2025). During this period, the EU believed that the world financial markets and the developed strategic relationships would naturally stabilise the geopolitical issues (Idriz, Kassoti & Larik, 2024).

However, after 2008, a "strategic awakening" occurred as systemic rivalries became more intense and the "weaponisation of interdependence" became a new reality (Farrell & Newman, 2019). The exposure of the risks that were associated with the Single Market occurred when systemic rivals implemented state-led investment strategies (Haroche, 2024). The turning point was the 2023 "Economic Security Strategy" which made investment screening a vital part of "Open Strategic Autonomy" (Bujak, 2025). Such strategy maintains the advantageousness of openness but prevents, at the same time, the abuse of it in the strategic fields like technology, infrastructure, and supply chain.

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, p. 1) represents the first attempt of the EU to create a unified framework for the screening of the foreign direct investments (Tepeš, 2023). Its "Original Sin" was that it was created as a consultative rather than a coercive scheme (Robert, 2023). As such, it was a cooperative mechanism that lacked the power to make Member States adopt national screening regimes and prevent certain transactions at the EU level. At the time of the introduction of this instrument, 14 Member States did not have any formal screening methods in place, and it created entry points that allowed foreign investors to access the entire Single Market through the least regulated jurisdictions (Pietkun, 2022).

## 1. INTEGRATION THROUGH LAW VS. GEOPOLITISATION THROUGH LAW

The European Project has been based on "integration through law" since the creation of the Court of Justice of the European Union (CJEU) and the creation of the legal principles of the European Union. In other words, the CJEU has eliminated barriers to trade and expanded market freedoms in Europe by using legal instruments. Today, however, we can see a new paradigm called "geopolitisation through law" (Poli, 2024). According to Groussot, Michael & Mlynarcikova (2024), under this new model, the European Union uses legal instruments to defend itself against external threats and protect the "Union public order" (Groussot, Michael & Mlynarcikova, 2024). In other words, the CJEU judgements moved from the traditional model of "negative integration," where the CJEU removes obstacles to trade, to the model of "positive integration," where the CJEU requires all Member States to implement the same investment security measures.

The multi-level governance model is also expanding with the requirement of mandatory screening (Crivoi, 2024). The European Commission has recently developed a narrative about "the economic security of the EU" that will allow it to expand its jurisdiction over

matters of national sovereignty (Nicolaidis & Meunier, 2024). Scholars have studied how this process is occurring through the lens of Giorgio Agamben's theory of the "State of Exception". This theory explains how the establishment of security exceptions creates a "blurred line" between the public law and the political fact, such that the judgments made in investment screening decisions are less subject to judicial review (Agamben, 2005). As a result, there is a growing trend of the "securitisation of competition," which enables the EU to create a new discourse of internal market policy emphasizing "security and public order" (Groussot, Michael & Mlynarcikova, 2024).

## 2. CASE C-106/22 (XELLA MAGYARORSZÁG): THE BIRTH OF THE INDIRECT LOOPHOLE

The "Xella epoch" refers to the legislative changes initiated by Case C-106/22, Xella Magyarország (Case C-106/22, 2023). The case concerned the decision of the Hungarian government to prevent the acquisition of Janes és Társa, a domestic mining company that extracted gravel, sand and clay, by Xella Magyarország. The ownership structure of Xella had a classical "matryoshka" hierarchy: the Hungarian acquirer was owned by a German parent; the German parent was owned by a Luxembourg holding company; the Luxembourg holding company was owned by a Bermudan parent entity; and finally, the Bermudan parent entity was owned by an Irish citizen. The Hungarian Minister for Innovation and Technology decided to block the acquisition because it would pose a risk to the security of raw materials, classifying Xella as a "foreign investor" due to its Bermudan upstream chain (Vacaru & Pascu, 2023).

In its ruling of July 2023, the CJEU drastically restricted the scope of application of the 2019 FDI regulation (Regulation (EU) 2019/452, OJ L 79I, 21.3.2019, p. 1). The CJEU stated that the Regulation only applies to investments carried out by companies established in accordance with the law of a Non-Member State (Berg et al., 2023). Since Xella was an undertaking established in Hungary, the transaction was therefore an intra-EU investment. Pursuant to Article 49 TFEU (Free Movement of Capital), the CJEU considered that any obstacle to the freedom of establishment must be justified by the existence of a "genuine and sufficient threat to a fundamental interest of society" (Case C-106/22, 2023). The CJEU concluded that the supply of gravel and sand did not constitute such a threat, particularly in view of the existing market position of Xella. Therefore, the CJEU gave precedence to market freedoms to the detriment of national security interests, provided that there is no "artificial arrangement" (Vacaru & Pascu, 2023).

The CJEU ruling has created a binding legal precedent: intra-EU subsidiaries are "invisible" to the 2019 framework unless the structure is artificial (Berg et al., 2023). This distinction has considerably weakened national authorities responsible for foreign direct investment control, who cannot use the coordination mechanism of the EU to regulate transactions involving EU-established entities, even if they are clearly controlled by third-country parties. This judicial validation of the "indirect loophole" has become the main reason for the 2024 legislative initiative to modify the definition of "foreign investment" (Gutman, 2024).

## 3. THE "MATRYOSHKA" MECHANISM: STRUCTURAL EVASION

Following Xella, sophisticated investors began adapting by using what were called "Matryoshka" structures, which referred to multiple layers of corporate entities located in

different jurisdictions (Hanapi, 2025). In general, a foreign investor would establish a holding company in a Member State that has traditionally had less stringent regulation, such as the Netherlands or Luxembourg.
Once the holding company was established in the EU, it could obtain the rights of an EU "national," thereby enabling the EU subsidiary to purchase strategic assets in other Member States, usually while avoiding the strict scrutiny afforded to investments made by non-EU entities (Freshfields, 2026).

A primary conflict exists between "artificial arrangements" and "a legitimate economic reality" (Gutman, 2024). As stated above, the 2019 Regulation was designed to prohibit the use of structures used solely for purposes of circumventing the required screening process; however, establishing what constitutes "artificiality" in a global financial context is challenging. For example, when an EU subsidiary has an office space, local directors, and legitimate business activities ("substance"), it is considered to be a "legitimate" entity, regardless of whether its ultimate strategic objective is to acquire strategic technologies. The Xella decision further complicated matters by imposing a high burden of proof on regulators to prove that an arrangement is artificial (Vacaru & Pascu, 2023).

In addition to using layered structures, investors also began to exploit the "9.9 Percent Stake" strategy purchasing shares in amounts slightly under the common 10 percent notification threshold. Although a 9.9 percent stake in a firm does not typically afford the purchaser voting power, it provides the purchaser with substantial "Effective Participation" by providing access to the Board of Directors, informational rights, or contractual "negative control" over intellectual property transfers. Therefore, by purchasing a mosaic of these sub-threshold stakes in each company in a particular supply chain, a foreign investor can achieve systemic influence without ever being required to file a mandatory notification (Schoenherr,2026).

## 4. THE 2024-2026 OVERHAUL: THE END OF MEMBER STATE SHOPPING

The most impactful change to the EU's FDI screening regime contained in the future 2026 Regulation is the requirement that all 27 Member States maintain a screening mechanism (Simmons & Simmons, 2026). This effectively brings to an end the practice of "Member State Shopping," wherein foreign investors selected jurisdictions that had yet to implement their screening regimes such as Cyprus or Croatia (the last two to do so) to gain access to the EU's Single Market (Clifford Chance, 2026). Through the imposition of mandatory screening mechanisms possessing the same core functions, including "call-in" authority for unreported transactions regulators will create a common outer perimeter (Baker McKenzie,2025).

As noted above, the new 2026 Regulation will create new limitations on the definition of "foreign investment." Specifically, it includes in the definition of foreign investment investments made by EU-based subsidiaries that are ultimately controlled, either directly or indirectly, by a foreign investor. The "Security Pass-through" ensures that the non-EU nationality of the UBO is carried down the chain of ownership to all subsequent subsidiaries. Consequently, the legal basis for the regulation is based on Article 114 TFEU, which enables the regulation at the EU level to ensure the security of the Single Market (Poli, 2024).

The overhaul of the screening regime creates a "Common Minimum Sectoral Scope" (Linklaters, 2025). Thus, all Member States must review investments in five key sectors:
1. Dual-Use and Defense Items.
2. Hyper-Critical Technologies, specifically General-Purpose AI (with defense applications), Quantum Technologies, and Advanced Semiconductors.
3. Critical Raw Materials, including materials necessary for the energy transition (Bujak, 2025).
4. Critical Infrastructure, including energy, transportation, and digital networks.
5. Fundamental Financial System Entities, including Central Counterparties and Payment System Operators (Bujak, 2025).

## 5. THE NEW LANDSCAPE: A “WEB” OF REGULATORY OVERSIGHT

For any non-European flagged investor, there are now potentially 29 separate approval requirements, including the national FDI screening regimes, the EU Merger Regulation (EUMR), and the Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (FSR) (OJ L 330, 23.12.2022, p. 1) (Kokkoris, 2025). In addition, while FDI screening primarily concerns issues related to security and public order, the FSR focuses on the distortion of the internal market through subsidies provided by third country governments which may result in unfair advantages for certain firms within the Union.

Table 1. Main differences between Regulation (EU) 2019/452 and 2026 Revamped Regulation

| **Feature** | **Regulation (EU) 2019/452** | **2026 Revamped Regulation** |
|---|---|---|
| **Mandate** | Voluntary (Encouraged) | Mandatory for all 27 Member States |
| **Scope of Investor** | Direct non-EU investors only | Direct and indirect (EU subsidiaries) |
| **Sectoral Coverage** | Indicative list (Flexible) | Minimum mandatory scope (Hyper-critical) |
| **Timelines** | Highly divergent across MS | Harmonized Phase 1 (45 days) |
| **Cooperation** | Information exchange (Non-binding) | Strengthened with shared EU database |
| **Greenfield** | Not explicitly addressed | Defined; optional/mandatory debate |
| **Enforcement** | Member State discretion | Enhanced accountability and "own-initiative" reviews |

Source: Author

Although the combination of both approaches is intended to create a "level playing field," it also introduces considerable legal uncertainty and the possibility of conflicting decisions by national and EU authorities (Kokkoris, 2025).

As stated above, the 2026 Regulation increases the role of the Commission to that of a "moderator" of collective intelligence. The Commission has created a common database, referred to as the "Shared EU Database." This database will contain information on each of the notified transactions and screening decisions (Freshfields, 2026). The "network effect" will be generated by this shared database; once an authority in one Member State blocks a transaction, all other authorities will be alerted and can act accordingly. The Regulation obliges the parties to attempt to file their FDI notification filings with all relevant authorities at the same time to avoid "sequencing" that would allow a party to hide the extent of a multijurisdictional acquisition (Mattiolo, 2024).

## 6. EXISTING GREY ZONES

Although the reform has made some progress in addressing grey zones, there are still many areas that require further clarification and regulation. One of those grey zones concerns "Greenfield" investment. While the 2024 proposal encouraged screening of these types of projects, the European Parliament called for a mandatory €250 million threshold for the screening of large scale greenfield projects in sensitive sectors (Baker McKenzie, 2025). The Council still does not want to establish limits for the screening of foreign direct investments in greenfields because it fears that such limits would discourage the creation of jobs through FDI. Consequently, at present there are no clear rules as to under what conditions an alien entity can create a significant physical and technological presence in the EU without undergoing a formal security assessment (AOShearman, 2025).

Another new concern relates to the increasing application of convertible debt. In such scenario, a foreign investor provides a significant amount of money as a loan to a distressed European company, providing that the investor is allowed to exchange the debt into equity or obtain the company's assets should the company go bankrupt.
Since convertible debt does not initially involve the transfer of ownership of shares, it typically falls outside the scope of pre-closing screenings. Even if the 2026 Regulation's focus on "effective participation" attempts to capture convertible debt agreements, however, the complexity of private debt markets is a major obstacle to effectively regulating this type of agreement (Gutman, 2024).

Finally, in the fields of artificial intelligence and biotechnology, the "talent pipeline" is a non-transactional FDI gap (Boyacıoğlu, Özdemir & Karim, 2024). Many competitors have come to employ what are known as "acqui-hires" —the process whereby a competitor hires the entire core research team of a start-up without purchasing the start-up itself— as a means of stripping the EU of its technical capabilities. Similarily, "strategic partnerships" or exclusive licenses can give a foreign entity control over the intellectual property rights and data of the partner without triggering traditional merger or FDI reviews (Chen, Hshieh & Zhang, 2023). For example, recent cases like the Microsoft/Inflection deal demonstrate how " pseudo acquisitions" may acquire a competitor's competitive capacity through the employment of the highly-skilled employees who possess unique, specialized knowledge (Elfenbein & Sterling, 2018).

## CONCLUSION

The recent evolution of the EU approach to the treatment of foreign investments reveals a deep transformation of the internal market logic. Traditionally based on free movement of capital, the EU has adopted a new protective way to face the geopolitical rivalry and strategic vulnerabilities following the 2008 economic crisis.

The development from Xella to the "Matryoshka" reform represents the maturity of the EU as a geopolitical player (Poli, 2024). By progressing from a consultative regime to a mandatory, security-focused "shield", the EU has sent a signal that it is no longer a "naive free trader" (Robert, 2023).

The 2026 reforms provide the means for the Union to close the indirect route and track complex ownership chains. However, the efficacy of this "geopolitical shield" will depend on the quality of information-sharing and the ability of the EU to deal with emerging gaps in greenfield investments and the non-transactional talent pipeline.

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