G|M|F The German Marshall Fund of the United States
STRENGTHENING TRANSATLANTIC COOPERATION

Paper Series

Stockholm China Forum

January 2015

Chinese Investment in the EU: A Challenge to Europe's Economic Security

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Summary: China's increasingly assertive role in international affairs and the international economy continues to raise concerns about its intentions and use of instruments such as foreign direct investment. An important step toward building the trust of foreign countries and businesses in China could be a properly constructed bilateral investment treaty between the EU and China. As part of the effort, the EU should consider establishing a special committee or a decentralized agency tasked with evaluating foreign investments.

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Introduction

The People's Republic of China's involvement in foreign markets, in terms of both trade and direct investment, has grown exponentially since Deng Xiaoping began to unlock that country's borders in 1979. Thirty years ago, China had virtually no funds embedded in foreign countries, but by 2013 that sum totaled nearly $90.2 billion, a 16.8 percent increase just over the previous year. China's increasingly assertive role in international affairs and the international economy continues to raise concerns about its intentions and use of instruments such as foreign direct investment (FDI). An important step toward building the trust of foreign countries and businesses in China could be a properly constructed bilateral investment treaty between the European Union (EU) and China. As part of the effort, the EU should consider establishing a special committee or a decentralized agency tasked with evaluating foreign investments. This institutionalized body would be similar to the U.S. Committee on Foreign Investment and could contribute to overseeing and facilitating Chinese investments in Europe. These kinds of safeguards could go a long way toward assuring skeptics about China's motives and actions.

Context

Not long ago, China directed the majority of its FDI toward the world's developing regions. Recently, however, it has been seeking a larger share of European and U.S. markets. With its surplus and currency reserves amassed over the past three decades, the destination of Chinese FDI has more recently been climbing the value chain just as other ascendant Asian economies (Japan, Korea) did before it. China seeks expertise and experience in higher-end industries and services. Currently, only a small fraction of Chinese FDI is directed at the United States and the EU. In 2009, Chinese FDI toward the United States accounted for only 1.4 percent of China's total outbound FDI. In 2012, only 2.2 percent of inbound FDI in the EU originated from China. But that ratio could and should grow markedly if recent economic reforms and promised liberalization in China take hold. In 2013, China received $117.6 billion in foreign direct investment. As China becomes increasingly integrated into the global economy, its own participation in global investment flows is expected to boom, with a projected $1 trillion in overseas FDIs by 2020.

In theory, the influx of Chinese wealth into the U.S. and EU economies should yield significant benefits to all parties. Both the EU and the United States stand to gain from more high-paying jobs, increased investment in research and development, and invigorated manufacturing bases. Chinese President Xi Jinping spent 11 days visiting Europe earlier this year, during which European presidents and prime ministers eagerly courted Chinese investment. By channeling China's FDI to the West and engaging in the most developed and complex markets, China also increases its potential for technology acquisition and transfer, the securing of vital goods and knowledge, and the increase of exports of U.S. and EU products back to China. The adoption of new benchmarks of corporate governance, accounting, and reporting by Chinese companies could also contribute to improving global supply chains.

Despite these benefits, Chinese FDI is beset with a problematic track record. There have been several high-profile instances in Europe where Chinese managers have failed to respect local legislation and displayed a general disregard for local authorities. For example, a Chinese company assumed control of the Greek shipping terminal Piraeus and only months later was cited for labor violations; a solar project in Italy became embroiled in fraud allegations involving false bonds and was shut down; a Chinese firm won a highway construction project in Poland but abruptly halted construction, leaving local subcontractors unpaid. And these cases are not exclusive to Europe; an iron ore venture in Australia ran five-fold over budget and four years behind schedule. In addition, when approached by foreign countries and businesses, the Chinese government has also failed to curtail illegal activities by national corporations; the former Mexican ambassador to China has publicly described the Chinese government's lack of cooperation in combating the export of methamphetamine precursors to Mexico.

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Well-intentioned Chinese investors often struggle in foreign markets and the EU market is no exception. Many investors lack familiarity and a basic understanding of European norms, standards and regulations. Such lack of knowledge often increases the risk and the cost of investing in Europe. In this respect, both European and Chinese investors would benefit from a more institutionalized process that would contribute to reducing these risks and costs. With their complex economic and political architectures, a two-level process may be appropriate: 1) a level that would monitor and assess risks that these investments might present for economic and national security in Europe; and 2) a level that would incentivize and assist specific Chinese investments in the EU.

Creating a Committee on Foreign Investments in the European Union (CFIEU)

Revisiting foreign investment regulations and processes is in the best interests of both China and host economies in Europe. One idea may be to establish a special committee or a decentralized agency within the framework of the EU that would be tasked with evaluating foreign investments, much like the Committee on Foreign Investments in the United States (CFIUS).

CFIUS is an inter-agency committee chaired by the secretary of the treasury and authorized to review transactions that could result in control of a U.S. business by a foreign person (also known as "covered transactions"). Other members of the committee include the secretaries of state, defense, homeland security, commerce and energy; the U.S. trade representative; the attorney general; and the director of the office of science and technology policy. All of these members work to determine the effect of transactions on national security. There can be up to four phases in the CFIUS process: pre-filing, review, investigation, and request to the president. CFIUS could decide to conduct an additional investigation should it conclude in its review phase that the proposed transaction presents concerns for national security. If there are no such concerns after the review or the additional investigation phase, the transaction can qualify for safe harbor. Ultimately, and only under a series of predetermined conditions, the president can be asked to block a foreign investment in the United States that would be threatening to national security. In this regard, the president of the United States remains the only person with the authority to suspend or prohibit a foreign investment.

Since its inception, the CFIUS process has undergone a range of amendments to increase congressional oversight, refine what constitutes a threat to national security, and address the challenge of foreign investments from state-owned enterprises. The increasing flow of inward investments from China has indeed played a role in current discussions about the role of CFIUS and the powers the process gives the president. Since its creation, the Committee has blocked a number of mergers and acquisitions targeting primarily high-tech firms and companies located near military bases.

Such roadblocks to Chinese FDI in the United States make European companies attractive targets for Chinese investors interested in Europe's technological and luxury goods. Just as the United States demonstrates its willingness to limit Chinese investments to guarantee control over its technological knowhow, a European version of CFIUS — or CFIEU, for short — could contribute to mitigating risks to European interests by reviewing, investigating, and vetting potential deals before they occur. This EU-wide process would complement already existing frameworks at the level of member states, but would not replace them.

At first glance, institutionalizing a review and assessment process of foreign investments based on their potential risk on economic and national security is not an easy task. At the EU level, it might also seem impossible due to the strict divide between EU competences and member state competences. As such, while the European Commission is competent to define and lead investment policy, it is not equipped to assess the impact of that policy on member states' national security. A CFIEU would therefore not follow the precise blueprint of CFIUS. But there are multiple ways for Europeans to be creative when it comes to institutionalizing a similar process.

Leveraging the Benefits of More Coordinated Investment Initiatives between the EU and China

In May 2013, the European Commission announced its intent to negotiate a bilateral investment treaty (BIT) with China. According to the EU, "a comprehensive EU-China investment agreement will benefit both the EU and China by ensuring that markets are open to investment in both directions. It will also provide a simpler, secure and predictable legal framework to investors in the long term." Providing this predictability to EU investors in China and to Chinese investors in Europe is crucial. More importantly, this will be the first investment-only agreement negotiated by the EU since the Lisbon Treaty granted it new powers, and one which will include provisions on market access.

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What would China gain from signing a BIT with the EU? Beijing desires to benefit from other trade and investments agreements currently being negotiated by others — such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) — by multiplying indirect bridges to these newly constituted free trade areas. The TPP, for one, is being negotiated between 12 countries in the region — the United States, Canada, Japan, Singapore, Vietnam, Australia, Brunei, Peru, Chile, Malaysia, New Zealand, and Mexico — which collectively comprise 40 percent of global GDP and 26 percent of global trade. China was ostensibly omitted from the list of partner countries. On the other side of the world, TTIP talks are underway between the United States and European Union. This initiative, started in June 2013, aims to bring down the last remaining tariffs between the United States and the EU, but also to remove non-tariff barriers to trade and investment, with the aim of setting global standards.

There are legitimate reasons to believe that these initiatives are aimed at containing China's rise and at providing leverage against its economic expansion. While immediate economic gains are uncertain for any of the countries involved in these two negotiations, it seems likely that some provisions will have a determining effect on Chinese investments and exchanges. In this context, an EU-China BIT could serve as a testimony of China's economic maturity. It could be the first step toward either a more formalized trade relationship with the EU, perhaps even with a future free trade agreement, or toward a bilateral investment treaty negotiated with the United States.

While many hurdles still exist for these initiatives to come to fruition, an ambitious EU-China BIT that would look beyond reciprocity could pave the way for a more symmetrical trade and investment relationship. This could also be an opportunity for both sides to discuss which mechanisms, procedures and institutions could be put in place in order to facilitate and guarantee European economic assets in China, and Chinese economic assets in Europe. Combined with a more formalized and generalized FDI review process in the EU, this could provide ex ante and ex post reassurances to both parties.

Conclusion

There is little rationale behind any idea that would seek to protect the EU from all Chinese investments. But specificities of Chinese investment policy and capacity tend to create misunderstandings and missed opportunities for all. In the long run, creating a framework where investments are funneled through more stringent channels with explicit consequences for non-compliance with regulations will help the Chinese become more responsible — and consequently desirable — business partners. Rethinking and revising procedures in place to govern investment relations between the EU and foreign parties will benefit all involved, and send a clearer message to Chinese investors in particular when it comes to the openness of European markets.

About the Author

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