EUROPE, A VALUES-BASED POWER

11 FEBRUARY 2019

#CHINA

#FDI

#BELT AND ROAD INITIATIVE

THE CHALLENGES OF CHINESE INVESTMENT CONTROL IN EUROPE

■ **ELVIRE FABRY**
Senior research fellow, Jacques Delors Institute

■ **JACOPO MARIA D'ANDRIA**
Research assistant, Jacques Delors Institute

While all major economic powers (including Australia, Canada, China, Japan, and the United States) have the capacity to control foreign direct investment (FDI), Europeans have only recently begun to coordinate to assess the risks posed by FDI into the Single Market. At present, only 14 European Union (EU) Member States have such mechanisms in place.[1]

The political agreement of 20 November 2018 to create a European mechanism will come to a vote in the European Parliament and to a qualified majority vote in the Council in the spring of 2019. This is a decisive step in the right direction. But for a more effective response, Europeans must acquire a better capacity to anticipate potential risks from FDI, including a common strategic perspective that must be put on the agenda of the next Commission.

1. Chinese investments in the crosshairs

The European Union is the world's most attractive region for FDI and intends to remain so. All Member States value FDI as a contribution to their competitiveness and economic development. This is all the more so in the context of economic recovery, even ten years after the financial and economic crisis. But on the one hand, a distinction must be made between green field investments and acquisitions in sectors sensitive to security or public order. On the other hand, the investment target deserves particular scrutiny when the investor is a state-owned enterprise from a third country or is under the control or influence of a third-country government. Finally, the overview of FDI at the EU level provides a better understanding of the medium- and long-term scope of each acquisition.

The control mechanism that would be put in place is non-discriminatory and it is the existing investments of several non-EU countries that are now in question, including the risks of interference in the media and electoral campaigns. But it was the Chinese government's increased investments in Europe that first motivated the creation of such a mechanism.

Not only did Chinese investment in the EU-28 increase from 0.7 billion Euro in 2008 to 29.7 billion Euro in 2017;[2] but the share of state-owned enterprise investment in total Chinese investment in the EU continues to increase. In just one year, from 2016 to 2017, the share increased from 35% to 68%. In addition, the share of Chinese FDI in Europe devoted to transport infrastructure has increased from 20% in 2016 to more than 51% in 2017.[3] These figures are indicative of the development mo-

1. Austria, Denmark, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Spain, and the United Kingdom. Three additional countries are in the process to adopt one : Sweden, Czech Republic, Malta.

2. 35 billion Euro in 2016.

3. Thilo Hanemann and Mikko Huotari, "Chinese FDI in Europe in 2017: Rapid recovery after initial slowdown, An update by Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS)", April 2018.

mentum of the Belt and Road Initiative (BRI), which was launched in 2013 by President Xi Jinping and includes massive investments in transport infrastructure to facilitate logistics and trade between Asia and Europe.

2. Focus on transport infrastructure and preliminary findings

By sharing information on FDI coming into their territory, Member States will have an overview of all sensitive sectors. Before this coordination will be put in place, we have drawn up a map of Chinese investments in European port, rail and airport transport infrastructure, which are of particular strategic interest to European trade and have been the subject of massive takeovers by Chinese investors in recent years.

Ports are important strategic nodes for the connectivity of people and goods with the rest of the world and decisive entry points to the Single Market, particularly for energy trade and distribution. In addition to their role in value chain logistics, they also have geopolitical implications, as they may play a key role in emergency supply or military operations.[4]

This snapshot of the dynamics of BRI developments in Europe, five years after its launch, calls for a more active anticipation of the benefits and risks it presents for Europeans, and for a coordinated strategy towards China– which more and more actors at the national and European level are calling for.[5]

The details of each investment that is pre-

4. European Sea Ports Organisation, "EU Ports Welcome Framework on Foreign Investment Screening as Useful Instrument for an Open Investment Environment", press release, 18 January 2018.

5. See the initiative "Connecting Europe & Asia: The EU Strategy", proposed by the European External Action Service in September

FIGURE 1 ■ Chinese investments in major EU transport infrastructure, 2004-2018

Source: Jacques Delors Institute, 6th February 2019. You can access the interactive version of this map by clicking on the image.

sented in the interactive version of this map (available on our website), which is compiled from data available since 2004, allow us to draw a first set of observations:

- **Chinese investments are mainly focused on European container ports.** Ports are strategic for EU-China trade; in 2016, 94% of EU-China trade by volume (corresponding to 64% by value) operated via sea lanes.[6]
- **The acquisitions already involve 14 European container ports,** which amounts to 10% of Europe's container maritime logistics capacity.
- **Chinese investments are targeting the most strategic ports.** In 2016, 74% of the EU's trade in goods with third countries was carried out by sea; 5 of the 10 most important ports for European trade logistics (by volume) have been the subject of Chinese investment: Rotterdam, Antwerp, Valencia, Piraeus, and Le Havre.[7]
- **There is a predominance of Chinese state-owned enterprises (SOEs)**. SOEs provide almost all Chinese investment in European ports.[8] For airports, these investments are either public (Heathrow), mixed (Toulouse) or private (Frankfurt), while the Chinese contribution to the financing of the Budapest-Belgrade rail project is provided in particular by two public banks, China Exim Bank and China Development Bank.
- **The Chinese government has a majority position in 6 of the 14 ports in which it has invested.**
- **The implementation of the BRI.** Chinese SOEs investing in Europe are also heavily involved in the expansion of the BRI across several continents.
- **A strategic integration of maritime transport services.** The SOE China Ocean Shipping Company (COSCO) has minority stakes in the ports of Rotterdam and Antwerp, and majority stakes in Bilbao, Valencia, Piraeus and Zeebrugge. COSCO is also part, together with another Chinese SOE, Orient Overseas (International) Limited (OOIL), of the world's most powerful shipping consortium, Ocean Alliance, which operates along maritime trade routes between Europe and Asia.
- **Diversification of logistics channels.** So far, Chinese FDI has targeted several maritime access routes from the Aegean Sea to the North Sea. As their current ambition is to open up Arctic sea lanes, Northern Europe could be the subject of future investment. But Beijing's efforts to engage Eastern European countries to contribute to the development of the BRI foreshadow a diversification of trade routes via the "China-Europe Express Train". For example, 12 Member States have already signed a Memorandum of Understanding on the BRI (Greece and the eleven Member States that are part of the 16+1 Forum with 5 Balkan countries).

While the reality of China's presence in Europe is taking shape in many other sectors, the coordination of Europeans to protect their strategic interests comes late. This inertia has already allowed the Chinese government's activism to block some European decisions with the support from Member States in which China has heavily invested. This has already occurred more in European deliberations on the protection of human rights in China and Chinese claims in the East- and South China Sea.[9] It is possible that a Chinese veto on data protection could be next.

2018.

6. In contrast to only 1% in volume and 2% in value for rail, 3% and 6% by land, 2% and 28% by air respectively - which is preferred for high value-added freight. Jonathan Hillman, "The rise of China-Europe railways", CSIS, 6 March 2018.

7. Shivali Pandya and Simone Tagliapietra, "China strategic investment in Europe: the case of maritime ports", Bruegel, 27 June 2018.

8. It should be noted that since the attempted merger of EDF and the Chinese state-owned company CGN in 2016, the European Commission considers that all public companies in a sector within the same country should be considered as a single entity when the rules of EU competition policy apply.

9. In July 2016, Hungary, Croatia and Greece blocked a statement by the High Representative for Foreign and Security Policy after the decision of the Hague Court of Arbitration rejecting the Chinese government's claims in the China Sea. Greece also vetoed an EU statement to the UN Human Rights Council in June 2017 criticising China.

3. The current control mechanism remains insufficient

While preserving the sovereign competences of Member States to authorise or reject investments on their national territory, the European mechanism has three main objectives:

- Strengthen the convergence of Member States' FDI control criteria;
- Ensure an exchange of information between Member States and with the Commission to create a common alert system based on an overview of FDI in Europe;
- Give another Member State and/or the European Commission the possibility to issue an opinion on FDI that would threaten security or public order.

Member States must notify their control mechanisms to the Commission, as well as FDIs undergoing a screening process and the annual report of aggregate FDI inflows to their territory. However, Member States are only asked to set up a control mechanism with minimum standards (in particular: transparency, non-discrimination vis-à-vis third countries, and judicial review of decisions). It is probably the main weakness of the political agreement reached in November that it only provides an incentive and not an obligation for the fifteen Member States that do not yet have a control mechanism to set one up.

The Commission or any other Member State may request additional information, governed by confidentiality criteria, if an unscreened or not-yet-screened investment project presents a risk to the security or public policy of at least two Member States or the requesting Member State.

The risk would be assessed broadly since it concerns:

- critical infrastructure (transport, energy, defence, water, health, communications, media, data processing and storage, space, financial or electoral infrastructure, as well as sensitive facilities);
- critical technology (artificial intelligence, robotics, semiconductors, civil-military technologies, space or nuclear technology, nano- and biotechnology, and quantum technology);
- secure supplies of essential inputs;
- access to or control of sensitive information, including personal data.

The Commission will be all the more vigilant towards these criteria when European programmes are concerned, for example for the Trans-European Transport Networks (TEN-T). It should be stressed that context and circumstances will be taken into account, for example whether the foreign investor is controlled directly or indirectly (through significant financing, including subsidies) by the government of a third country, and whether the investment "aims to develop a project or programme led by the government of a third country".[10]

If the investment presents a risk, the Commission or any Member State may then make a recommendation to the concerned Member State to initiate a control procedure or can make a recommendation concerning an ongoing procedure. Even in the case of a non-binding opinion, it will nevertheless be possible to enter into consultation with the concerned Member State. This European coordination, based on improved legal predictability and transparency, would promote the exchange of good practices and information on FDI developments.

But for such a mechanism to be efficient in assessing the risk of Chinese government investment in Europe, the EU still needs a coherent strategy towards China.

4. Priorities for the next Commission

- The Chinese government's initial narrative on the BRI presented the project as a "win-win" for all partners, as it would

10. Recital 13 of the political agreement on the control mechanism, "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)0487 – C8-0309/2017 – 2017/0224(COD))".

facilitate trade between Europe and Asia. Europeans could only welcome the prospect of better access to the ever more promising Asian markets, with their growing middle classes whose purchasing power is constantly increasing. But the modalities of implementing this connectivity, driven by Beijing, and involving a growing number of connections between China and the European flanks, are already raising questions. While the United States has limited FDI in its ports, particularly after 2006, when it blocked United Arab Emirates investments in six ports, and further strengthened its capacity to control FDI with the Foreign Investment and National Security Act (FINSA) in 2007 and the Foreign Investment Risk Review Modernization Act (FIRMMA) in 2018, the EU should also become more strategic in its approach.

- What will be the long-term impact of the Chinese government's increasing control of the European port infrastructure? Should we fear distortions for European trade? Can the reduction in logistics costs, nominally targeted by Chinese investments, make these ports more attractive and divert trade flows to their benefit? Could these ports facilitate illegal trade, in particular in light of recent European Anti-Fraud Office (OLAF) notifications of infractions in the port of Piraeus?[11] What about the ability of Member States to ensure customs controls in these ports, which are destined to receive an increasing volume of goods? While Chinese navy vessels have already docked in Piraeus, is it possible that we could see the development of a hitherto unlikely military use of European port infrastructure in which the Chinese government has acquired a majority position?
- Moreover, strategic investments by Chinese SOEs in Europe illustrate Chinese trade distortions that Europeans are trying to counter in their bilateral negotiations for an investment agreement and in the context of strengthening multilateral WTO rules.[12] First, there is lack of reciprocity in market opening, since China does not offer FDI the same access to its market as Europeans do to theirs – especially for infrastructure. This also touches on the opacity of Chinese financing and the lack of post-WTO notification of subsidies to SOEs, which therefore bypass WTO anti-subsidy rules. Strong convergence between Member States is necessary to influence the Chinese government and to obtain such reciprocity. By favouring short-term profits over the long-term interests of some Chinese FDI, several Member States are exposed to pressure from the Chinese government that could lead to the vetoing of European decisions.
- Finally, the EU has to make efforts to decipher Chinese intentions and the long-term geo-economic scope of the BRI, which already extends over several continents. A first step would be to ensure that Europe does not expose itself to an uncontrolled transformation of bilateral trade with China. What new type of interdependence does the diversification of logistics routes, such as express trains or the opening of the sea lanes in the Arctic, promote? Without more reciprocity in the opening of the European and Chinese markets, will increased connectivity not likely going to primarily serve Chinese interests?

The FDI control mechanism will be a key part of the framework that the EU must actively put in place to protect its strategic interests. However, the control of FDI in Europe must be closely coordinated with other European policies. In particular, it cannot be separated from the issue of European FDI in third countries. This calls for a greater integration of economic and political issues into the Common

11. Chinese imports to port of Piraeus have accessed the Single Market via the United Kingdom without paying corresponding customs duties. Francesco Guarascio, "EU warns UK-centered China import scam may shift to Europe's 'Silk Road'", Reuters, 6 June 2018.
12. Elvire Fabry and Erik Tate, "Saving the WTO Appellate Body or Returning to the Wild West of Trade?", Policy paper n°225, Jacques Delors Institute, 30 May 2018.

Foreign and Security Policy (CFSP) and for an appropriate organisation within the Commission, and between the European External Action Service (EEAS) and the Commission. Such coherence of European policies and instruments is more necessary than ever with regard to China and would justify an update of the EU competition policy to facilitate the creation of EU champions such as Airbus. The EU should aim to develop a clear strategy towards the BRI that will counter the trade distortions of Chinese state capitalism and maintain control over increased connectivity between Europe and China.

18 rue de Londres, 75009 Paris
Office in Brussels: rue du duc 139, 1200 Brussels
info@delorsinstitute.eu
www.institutdelors.eu