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## **Chinese Direct Investment in Europe : Economic Opportunities and Political Challenges**

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**Abstract:** Over the past decade, China has become one of the largest senders of foreign direct investment (FDI) in the world, including in the European Union (EU). Why did this rapid surge happen and how did European countries react politically to this new phenomenon, which some have presented as unprecedented and even dangerous? After surveying the recent evolution of Chinese FDI in Europe, this chapter analyzes the match between Chinese demand for European assets and European supply of assets after the outbreak of the euro crisis. The last section considers the political challenges raised in Europe by the rapid and ubiquitous rise of Chinese FDI and some of the policy responses to these challenges.

**Keywords:** China; euro crisis; EU; European Union; FDI; investment

Chinese outward investment into the European Union (EU) has increased very rapidly over the past decade. From a non-existent player fifteen years ago, China has now become one of the largest senders of foreign direct investment (FDI) flows in the world. In Europe, China has seemingly become an ubiquitous investor from airports to ports, hotels to automobiles, and English to Italian football clubs. This surge of Chinese investment has been particularly noticeable because it occurred in a context of decreasing investment worldwide in the wake of the United States (U.S.) financial crisis and it has been widely covered in the media, often through sensationalistic headlines.

From the perspective of China, investing in Europe has been very beneficial. It has notably enabled Chinese firms to acquire technology and know-how, enhance their reputation through the brand recognition of their acquisitions, and establish a logistical foothold in one of the world's largest consumer markets. Outward direct investment in Europe has also posed several challenges for the Chinese government, such as the negative ramifications of failed investment deals, as well as concerns about capital flight, particularly as a result of the anti-corruption campaign within China.

From the perspective of the host countries, this new source of foreign investment has brought economic opportunities, in particular to EU countries that have been suffering from high unemployment and low growth in the wake of the euro crisis. The new influx of Chinese investment has also ushered in a series of political challenges, as these countries are not used to dealing with foreign investors from less advanced economies, non-democratic regimes, or states outside of their security alliances. Additionally, it has strained European unity, as EU Member States have developed divergent reactions to these challenges.

This chapter explores why this rapid surge in Chinese direct investment into Europe happened and how European countries balanced economic benefits against political costs in their political reactions to this new phenomenon, which some have presented as unprecedented and even dangerous. As of writing, there has been neither uniform, nor unified European response to Chinese investment, even though the EU is simultaneously negotiating a bilateral investment treaty (BIT) with China and crafting a new mechanism for screening foreign direct investment at the EU level.

The chapter proceeds as follows. Section 1 briefly presents the surge of Chinese FDI in Europe and disaggregates the phenomenon, notably by host country, economic sector, investment type, investor type, and size. The chapter then explores the match between Chinese demand for European assets and European supply of assets after the outbreak of the euro crisis. Section 2 analyzes the motivations of Chinese investors for going into Europe, as well as the challenges that it creates domestically and internationally for the Chinese government. Section 3 explores the economic costs and benefits of this surge of Chinese investment for European host countries. The last section analyzes the domestic political reactions to this surge -- including fear of impact on standards, national security implications, and changes in foreign policy positions -- and explores the political response to Chinese investment at the collective European level. The conclusion speculates on the impact of new developments in world politics, including Brexit and the Trump presidency, on the future of Chinese investment in Europe.

## **The Evolution of Chinese FDI in Europe**

Chinese direct investment into Europe has risen very rapidly over the past decade. This section presents the surge of Chinese FDI in Europe and disaggregates the phenomenon, notably by host country, economic sector, investment type, and investor type.

### *Sources of FDI in Europe*

The United States holds by far the biggest share of direct investment stocks in Europe, with 41 per cent of total EU-28 FDI inward stocks from the rest of the world in 2015, followed by Switzerland with 10 per cent (Eurostat 2017). By contrast, investment coming from China accounted only for 0.6 per cent of European inward FDI stock in 2015, with a value of 34.9 billion euros.

This small stock volume, however, masks the reality of a very rapid, almost exponential, rise of Chinese outward direct investment over the past decade, which coincided with the sharp decline of FDI worldwide until 2012 in the wake of the U.S. financial crisis and the euro crisis. This rise happened all over the world: from virtually non-existent in 2005, China is now one of the top three home countries for FDI inflows. In Europe, Chinese investment started to take off around 2008 and increased very rapidly. Like in the U.S., over half of all Chinese FDI flows in Europe and the U.S. since 2000 have taken place in the past three years (Baker McKenzie and Rhodium Group 2017). In the EU, FDI from China rose 90 per cent in 2016. According to some measures, after 2008 Europe has become the fastest growing destination for Chinese outward investment (Ma and Overbeek 2015). A 2017 report by *Ernst & Young* estimates that during the

first six months of 2016, China invested more than \$70 billion in European companies (including in Switzerland), or as much as in 2013, 2014, and 2015 combined (Ernst & Young 2017).

### *Geographical diversity*

Chinese FDI has located throughout the European Union, with some noticeable patterns. First, Chinese investors have initially focused, like other foreign investors, on the “core member states” – Germany, the United Kingdom (UK) and France (Ma and Overbeek 2015; Baker McKenzie and Rhodium Group 2017). Chinese investment rose quickly in these three countries from 2008 on and continues to rise. In Germany alone, FDI deals from China have multiplied by 10, from \$1.3 billion in 2015 to \$12.1 billion in 2016. In 2016, Germany and the UK were the home of 46 per cent of all investment in Europe (Baker McKenzie 2017; ECFR 2017).

Second, Chinese investment in Southern member states increased rapidly in the wake of the euro crisis. Portugal and Spain have become important destinations for large Chinese FDI deals, notably in the utilities sector. China has also become a major source of foreign investment in Greece, the European country hardest hit by the crisis. By 2015, Southern European states accounted for about 40 per cent of all Chinese FDI in the EU.

Third, recent entrants in the periphery of the EU in Central and Eastern Europe are increasingly becoming hosts to Chinese direct investment as part of the Belt and Road Initiative (BRI), especially in Hungary (Ma and Overbeek 2015). The objective of the Chinese government is to create an integrated network spanning a "New Silk Road" from China through Central Asia to the Mediterranean. This strategy therefore involves infrastructure investment in ports, airports, railways, and roads across the Balkans and into the EU.

### *Sectoral diversity*

In addition to geographical diversity, Chinese FDI in Europe is also characterized by sectoral diversity. Initially, Chinese investment in Europe focused on the financial industry and natural resources. After a decade of Chinese investment in Europe, few patterns are now discernable as Chinese FDI has targeted all economic sectors, including energy, automotive, infrastructure, food, tourism, industrial machinery, entertainment, real estate, and so on.

### *Investment type*

The majority of Chinese FDI in Europe has taken the shape of mergers and acquisitions (M&As), rather than greenfield investment. In 2016, acquisitions drove 97 per cent of the value of FDI activity in Europe and the U.S.(Baker McKenzie 2017). China invests mainly through M&As in Western Europe, while most of its European greenfield investment has occurred in Central and Eastern Europe. Large transactions with a value of over \$1 billion drove up the value of Chinese FDI in Europe in recent years, but the majority of investment deals happen through small and medium sized Chinese investors (Baker McKenzie and Rhodium Group 2017). As for the nature of the investors, state-owned enterprises (SOEs) constitute the majority of Chinese investors, but private companies are playing an increasing role, with close to 40 per cent of total deals in 2014 (Baker McKenzie and Rhodium Group 2017).

### **Chinese Supply of Direct Investment to Europe**

From the perspective of China, investing in Europe responds both to economic and to political imperatives, though it may also bear political costs. This section explores how outward FDI in Europe has notably enabled Chinese firms to acquire technology and know-how, enhance

their reputation through the brand recognition of their acquisitions, and establish a logistical foothold in one of the world's largest consumer markets. At the same time, it has posed several political challenges for the Chinese government, such as the negative ramifications of failed investment, as well as concerns about capital flight, particularly as a result of the anti-corruption campaign within China.

### *Benefits for China as Home Country of Investment into Europe*

The emergence of outward Chinese FDI started first in response to a political imperative to “go out” –a term first coined by China’s Former President Jiang Zemin in 1997. “Going out” evolved from slogan to policy in China’s subsequent 10th, 11th and 12th Five-Year Plans defining in which areas the Chinese government wanted its companies to invest. For two decades now, Chinese firms and their managers have received a series of carrots and sticks, such as financial incentives and individual career advancement, to internationalize their operations,. While the initial Chinese outward investments were focused on natural resources and raw materials, notably in Africa, it was only in the late 2000s that direct investment from China began to arrive in European countries, where the political and regulatory hurdles were more complicated to navigate.

The “Going Out” policy was in part motivated by politics –and geopolitics. Outward FDI, a symbol of economic power, has been about regaining China’s international respect and place in the world. The successive financial crises in the U.S. and Eurozone have opened a window of opportunity for the Chinese to prove themselves and gain a stronger foothold in the global economy by increasing their relative FDI power.

The “Going Out” policy was also enacted, for the most part, to bring a multitude of economic benefits to China (Meunier and Knapp 2012), including the following:

Technological progress: Foreign acquisitions are a way for Chinese companies to obtain advanced technology in order to catch up with Western firms across a wide array of sectors. For instance, the 2016 acquisition of German robot-maker Kuka is expected to enable its investor, Chinese appliance company Midea, to use leading-edge German technology to automate its vast manufacturing operations in China (Bloomberg 2017).

Know-how: Similarly, outward FDI, be it greenfield or acquisitions, helps Chinese companies gain some valuable know-how, both as managerial talent and best practices. They also need the help of a highly educated, skilled European workforce to learn how to move up the value chain in China. Chinese investment in the French wine sector, for instance, is helping to develop a wine industry in China.

Brand reputation: China is in need of recognizable global brands, which foreign acquisitions may bolster. Few Chinese brands beyond Lenovo, Huawei and Haier have a global reputation, and even those have relatively short histories operating in international markets. For instance, the takeover of Swedish car manufacturer Volvo was a quick way for the Chinese automaker Geely to build its own brand reputation, both inside and outside China, rather than to develop it from scratch. Many Chinese companies are trying to replicate this model.

Circumventing Trade Barriers: Like Japanese companies did when they invested in the United States in the 1980s, Chinese companies are investing in Europe to avoid potential trade barriers such as duties, tariffs and subsidies. This has happened, for instance, in the case of photovoltaic solar panels where a trade barrier introduced in 2013 to protect European firms from Chinese dumping resulted in increased Chinese direct investment in the sector in Europe (McCarthy 2016).

Diversification of risk: For China, the benefits of investing in Europe have also included portfolio diversification and risk reduction. China has already invested a significant amount of its more than US\$3 trillion dollar foreign-exchange reserves into the U.S. economy as dollar-denominated assets such as government and institutional bonds. China also manages another estimated \$400 billion through its sovereign wealth fund, China Investment Corporation (CIC). After the U.S. financial crisis in 2008, China, rich in foreign currencies, made it an explicit policy to diversify these holdings both away from the U.S. and away from sovereign debt (Ma and Overbeek 2015).

In recent years, the “going out” strategy has been supplemented by two other policies that pursue similar economic and political objectives. One is the Belt and Road Initiative (BRI), launched in 2013. Also referred to as the One Belt, One Road (OBOR) initiative and the New Silk Road, it aims to connect the Chinese economy with countries along the ancient silk and maritime roads, crossing Central Asia all the way to Western Europe, through infrastructure and logistics. The second policy is the “Made in China 2025” objective. Launched in 2015, it is an industrial policy plan for China to become self-sufficient across a range of industries by 2025

through a combination of government subsidies, national champions, and foreign acquisitions. Both policies have resulted in the recent acceleration of Chinese direct investment in Europe.

### *Costs of Chinese Direct Investment in Europe for China*

While investing in Europe has the potential for a multitude of economic and political benefits for China, it also bears some costs, both internal and external.

Internally, the explosion of Chinese outward investment has facilitated capital flight. Foreign investment may have served as a disguised way to bypass capital controls and put money abroad by individuals who have acquired their fortune through corrupt means. In late 2016, as part of its anti-corruption campaign, the Chinese government imposed tighter controls on outbound investment to crack down on “irrational” FDI, notably for Chinese companies undertaking major acquisitions of foreign firms unrelated to their core business. It also established stricter approval requirements for cross-border deals of over \$10 billion. In November 2017, the Xi administration codified these new guidelines for companies investing overseas. On the one hand, it streamlined the approval process for deals that fit Beijing’s strategic priorities, such as in advanced technology, brands with global prestige, and the Belt and Road Initiative (Wildau 2017). On the other hand, it established punishments for some outbound investments and raised oversight for deals in sensitive sectors and countries, notably in real estate, hotels, sports clubs, and the entertainment industry (South China Morning Post 2017).

Externally, some outbound investment deals have the potential to reflect negatively on China. Chinese investment in a symbolic European company can potentially create unwanted negative international exposure and political backlash, similarly to what happened to Japan when its companies acquired symbolic assets in the U.S. such as Rockefeller Center in the late 1980s.

If it does not go through, an acquisition of a European company by a Chinese investor can reflect negatively on China, for instance if the deal was rejected because of national security reasons or because there was something wrong with the investor who failed to acquire financing. For instance, the mystery surrounding the identity and whereabouts of the lead investor in the Toulouse-Blagnac airport led to a stream of negative media coverage about Chinese FDI in France in 2015.

### **European Demand for Chinese Outward Investment**

For the reasons outlined above, the surge of Chinese investment in Europe coincided with the outbreak of the euro crisis (Meunier 2014a). From the perspective of the European host countries, this new source of foreign investment has brought economic opportunities, in particular to EU countries that have been suffering from high unemployment and low growth in the wake of the euro crisis. This section explores the evolution of the demand side of foreign investment from European countries over the past decade by analyzing first the increased supply of European assets and then European efforts to attract Chinese inward investment.

#### *An Increased Supply of Available European Assets in the Wake of the Euro Crisis*

The euro crisis increased the volume of European assets available for investing and thus created opportunities for bargain deals. The supply of European assets for sale increased because of the bursting of real estate bubbles, industrial and commercial bankruptcies, and the implementation of privatization programs.

In some EU countries, the euro crisis manifested itself as a real estate crisis. In Spain, a property bubble, which had swelled in the decade prior to the U.S. financial crisis, burst in late

2008. Real estate prices dropped almost 40 per cent over the next five years. Millions of empty housing units, many of which had been built in the 2000s, became available for purchase. A similar dynamic was at play in Ireland, where property prices dropped by 35 per cent between 2007 and 2010.

In other countries, the euro crisis took the form of bankruptcies. Low-growth or negative growth led to a vicious cycle of industrial and commercial bankruptcies, which resulted in unemployment, which in turn triggered further bankruptcies, and so on. This dynamic was particularly acute in Greece where one business after another closed down. As a result, a plethora of industrial and commercial assets became available.

The bulk of the euro crisis, however, was a public debt crisis. Countries burdened by debt chose to sell some of their state-owned assets to alleviate their debt. In the case of bailouts that needed to be repaid, states were forced by their creditors to sell their public assets as part of privatization programs, notably in Greece, Portugal, and Spain. Assets put up for sale included in particular public utilities, tourism facilities, and transportation infrastructure, such as ports and airports. Many of these assets were likely undervalued since they had to be sold under pressure and duress.

### *European Efforts to Attract Chinese Direct Investment*

While more assets, public and private, became available as a result of the euro crisis, the internal demand for these assets dried up in Europe, where fewer local buyers had become able to invest. At the same time, Chinese demand for European assets was surging as a result of the political and economic objectives presented in the previous section. European policy-makers

chose to make Chinese investment in Europe easier and to proactively seek out Chinese investors through promotion efforts and incentives.

In the short term, many policy-makers in Europe saw Chinese investment as beneficial in the context of the crisis because it could save a company from bankruptcy, preserve jobs, and put money in the state's coffers through privatization programs. In the longer term, Chinese investment seems key for European companies to penetrate the coveted Chinese market. For instance, in 2014 the Chinese company Sanpower Group acquired the venerable British retailer House of Fraser with the objective of launching the brand globally. It now has outlets in China and sells mostly British products there.

European policy-makers embarked on active promotional efforts to attract potential Chinese investors. Mayors, local representatives, and heads of state and government have been busy traveling to China and literally rolling out the red carpet in welcoming Chinese officials to their country in the hope of attracting investment to their country. Such visits have often been accompanied by announcements trumpeted in the local media of lucrative investment deals, but those have not always been followed through with actual M&As or greenfield investment.

Local and national policy-makers have also sought out Chinese investment through the granting of incentives, such as tax breaks and infrastructure. However, the EU regulates strictly the type of investment incentives offered, mostly through its state aid policy. In some cases, governments have even tried to encourage directly Chinese individual investors by offering them residency permits and even citizenship in exchange for certain amounts of investment, for instance in real estate or in companies employing a certain number of workers.

At the EU level, Chinese investment is also actively encouraged. At the 2015 High-Level Economic and Trade Dialogue, China committed to contributing a 315-billion-euro Investment

Plan for Europe, the so-called “Juncker Plan.” In December 2015, China became the 67<sup>th</sup> member in the European Bank for Reconstruction and Development (EBRD). In June 2017, the European Investment Fund (EIF), part of the European Investment Bank Group, and China's Silk Road Fund (SRF) signed a Memorandum of Understanding with the aim of jointly investing in private equity and venture capital funds that will, in turn, invest in small and medium-sized enterprises located in the EU (European Commission 2017).

As a result of what seems like a convenient match between Chinese demand for European assets and European supply of assets, Chinese investment was able to surge in Europe, both in the public and private sectors. The share of Portugal, Ireland, Italy, Greece, Spain and Cyprus in total Chinese inbound EU investment grew from 8 per cent in 2009-2011 to 33 per cent in 2012-2014, according to a report by the European Trade Union Confederation based on data from Baker & McKenzie and Rhodium Group (Baker McKenzie and Rhodium Group 2017). For instance, in Portugal, Chinese investors acquired 45 per cent of the total assets put for privatization under the Economic Adjustment Program and the International Monetary Fund in sectors such as electrical infrastructure and financial services (Martin 2014). In Italy, Chinese companies invested in the power grid, deals that were made possible by a privatization program by former Prime Minister Matteo Renzi in order to reduce Italy's national debt. In Greece, Chinese investors were able to take advantage of the many opportunities offered by the privatization program designed to meet the bailout conditions, including COSCO's investment in the port of Piraeus in Athens (Meunier 2015). In Germany, Chinese investors acquired small- and medium-sized family companies that had been hurt by the global financial crisis, such as the Sany Group's acquisition of concrete pumpmaker Putzmeister, whose revenue and staff had been cut by half since 2008 by the time of its takeover in 2012 (Ewing 2014).

It should be noted, however, that many Chinese acquisitions in the wake of the euro crisis were not economic bargains per se. In several cases, these acquisitions were the result of public battles where Chinese investors outbid other interested parties by paying a hefty premium –such as was the case with Fosun’s acquisition of the French resort chain ClubMed which took place in 2015 after an expensive, protracted two-year takeover battle. Neither did Chinese investors jump at the opportunity to acquire all the European assets at bargain prices, many of which are still for sale at the time of writing (Meunier 2018).

### **European Reactions to the Political Challenges Raised by Chinese FDI**

While European countries have overall welcomed and even courted Chinese direct investment, they have also faced new political challenges, notably in dealing with foreign investors from less advanced economies, non-democratic regimes, and states outside their security alliances. However, a growing national populism in European countries is turning increasingly negative towards globalization and towards “others”, including foreign investment. This section analyzes the domestic political reactions to this surge in Europe and explores the political response to Chinese investment at the collective European level.

#### *Three Sources of Political Challenges Caused by Chinese Investment*

Overall, attitudes towards Chinese investment are quite positive throughout the EU, especially in Southern and Eastern Europe. However, three characteristics of Chinese investment in particular seem to pose political challenges to European countries as well as to other advanced industrialized economies for that matter.<sup>1</sup>

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<sup>1</sup> This section is heavily based on Meunier (2018).

## An Emerging Economy

In spite of its spectacular growth over the past few decades, China is still an emerging economy. This characteristic poses its own set of political challenges when European countries host FDI from China. First, the influx of direct investment from a developing to a developed economy, which has no historical precedent, shakes the traditional political dynamics of FDI and poses somewhat of an existential problem for the host countries, since historically direct investment has flowed almost exclusively from developed to developing economies and capital has been a source and symbol of power (Meunier, Burgoon, and Jacoby 2014). Chinese investment into Europe can be interpreted as an external sign of the gradual slide of Western power relative to the rising power of China.

Second, the usual benefits for the host economy that accompany inward foreign investment may not happen in a case where the investor is from a less advanced economy. FDI always has costs and benefits for the host country, but typically the benefits outweigh the costs through technological and know-how spillover into the local economy as workers and R&D move from foreign-owned to national firms. In the case of Chinese investment, however, some fear that the net positive economic impact may not happen because the technological and know-how flows do not appear to be going in the ‘traditional’ direction, from the home to the host country. With the exception of a few sectors, such as telecom equipment and port management, Chinese investors seem to be looking to invest precisely in Western firms whose main assets are their superior technology and know-how --from robot machinery to aircraft leasing and football clubs. An Italian analyst has called this the “reverse Marco Polo effect” (Valli 2012).

Third, the differentials in technology and wages between the emerging economy investor and the developed economy host country may potentially lead to asset-stripping. In that case, the

Chinese investor could repatriate to China the assets of the company it took over and virtually close up shop in the host country –some critics even talk of a “siphoning off”. For the host country, in the short term such a scenario would bring only the costs of FDI, not the benefits, notably because the foreign investment would accelerate the loss of local employment. In the long term, the consequences could be even more damaging as the host country would see an erosion of its competitive lead.

### A Unique Political System

A second feature making Chinese investment different from historical precedent is the uniqueness of China’s political system and of “capitalism with Chinese characteristics”, which potentially pose several political problems for the host country. First is the central role of the Chinese state in the economy. For one, the injunction to Chinese firms to “go out” has been the official policy of the Chinese government in successive five-year plans since 2000, later reinforced by the One Belt, One Road policy and the “Made in China 2025” objective, as discussed earlier. Therefore, it is rational for host countries to interpret Chinese FDI as being directed centrally by the Chinese government.

Moreover, the nature of the relations between Chinese investors and the Chinese government is often confusing. Even when transactions are conducted by private investors instead of SOEs, doubt persists as to the actual influence of the Chinese government and the Communist Party. Moreover, the lack of transparency of the governance structure of Chinese firms, whether state-owned or private, makes the investment transaction difficult to comprehend for the target company or the host country. In some cases, the deal by a Chinese company seems to have been spearheaded by someone who was either mysterious or not the actual person in

charge –a public example of this happened in the case of the acquisition of a stake in the Toulouse-Blagnac airport in France by a Chinese investment consortium headed by Mike Poon, who later mysteriously disappeared. The opaque involvement of the Chinese government in the decisions of its companies to invest abroad also leaves some lingering doubt as to the ultimate rationale for the investment. Is it purely a commercial decision responding to market incentives or is there an ulterior, strategic motive to the deal?

The Chinese political economy model of state-led capitalism also leads Chinese companies to assume a different attitude towards risk than do market-driven capitalist companies. The Chinese state conducts explicit industrial policy whereby national champions are identified and backed with abundant subsidies and administrative help. They have access to cheap credit. This enables these companies to take more risks and be less concerned about immediate return and bottom-line. They can plan for the long instead of the short term and, therefore, offer bids which are higher than those of their privately-owned competitors.

Finally, the political economy of Chinese investment leads to fears that the government can manipulate the transactions by using its special leverage. This fear was illustrated by the case of Aixtron, a German technology company specializing in semiconductors. In 2015, Sanan Optoelectronics, a Chinese customer of Aixtron, canceled a large order at the last minute, which provoked a crash of the price of Aixtron's shares. A few months later, the Chinese investment fund Fujian Grand Chip made a deal to acquire Aixtron. According to the press, Sanan and Fujian had many connections, including a common investor, and were both linked to the Chinese government (Mozur and Ewing 2016).

## Not a Security Ally

A third source of political challenges posed by Chinese FDI comes from strategic security considerations. European countries are not used to receiving investment from countries that are not their security allies. The Soviet Union did not invest in the West during the Cold War. To be sure, China is not an enemy but rather a superpower with avowed geopolitical ambitions and foreign policy goals often at odds with those of the U.S. and some European countries. This raises several causes for concern about the ultimate motive of investment, including issues of dual-use technology and strategic leverage.

One concern relates to the efforts by Chinese investors to acquire technology abroad, which is problematic from a security standpoint for at least two reasons. First, even though China itself is not a security enemy, it is on friendly terms with some countries considered pariahs or rogue states in the West, such as North Korea. Some of the technology acquired through Chinese FDI in Europe could make its way in the hands of their leaders, with possible security implications. Second, some Chinese investments that may seem innocuous at first glance may indeed have security implications. This could be, for instance, because of their strategic location, such as CASIL's investment in the Toulouse-Blagnac airport in France in 2015, a deal which went through despite its location adjacent to the Airbus factory. It could also be because of the dangers of dual-use technology, with technology peacefully employed in everyday consumer products having the potential to be adapted for military use.

Another security concern relates to the risks of political leverage and control arising from foreign ownership and, therefore, dependence. One potential risk is physical leverage. For instance, the Chinese owner could strip the assets of the company acquired in the host country, for instance machinery or intellectual property, provoking lay-offs in the short term and

removing competitive advantages in the longer run. Countries worry particularly about specific physical risks (e.g. sabotage, espionage, control) associated with foreign ownership of sensitive critical infrastructure, such as nuclear power plants. This was the crux of the decision by British Prime Minister Theresa May to reexamine and delay final approval of the Hinkley Point deal in 2016, on the grounds that China could build weaknesses on purpose into some of the nuclear safety systems or could shut down British electricity production at will, thereby unleashing chaos in the country.

Another potential, and more subtle, risk is political leverage. China could potentially use its ownership of foreign assets to pressure and even coerce host governments into falling in line on the political issues that the Chinese government cares deeply about, such as the one-China policy, the question of Tibet, and the issue of human rights (Meunier 2014b). The higher the dependence of a foreign country on Chinese investment, the larger we could expect the implicit or explicit leverage of China. Some observers have interpreted as such the June 2017 Greek vote to block a proposal from EU member states for a common European resolution regarding human rights abuses in China, arguing that “while Europe was busy squeezing Greece, the Chinese swooped in with bucket-loads of investments that have begun to pay off, not only economically but also by apparently giving China a political foothold in Greece, and by extension, in Europe” (Horowitz and Alderman 2017).

### *Towards a Unified EU Response?*

These political challenges caused by the surge of Chinese FDI into Europe have been perceived differently by the various EU countries. The main line of cleavage separates the countries with advanced technology and know-how from the others. The big Western European

economies are concerned about the long-term implications of Chinese investment for their economic competitiveness. In the UK, the Hinkley Point deal, a project for France's EDF and China's CGN to construct a new nuclear power plant in Somerset, England, provoked political debate and great media coverage in 2016 about the soundness of this deal in particular and of Chinese investment in the UK in general. Simultaneously, the takeover of German robot-maker Kuka by Chinese home appliance maker Midea prompted the German minister of the economy Sigmar Gabriel to propose an expansion of the 2009 Foreign Trade Law (Aussenwirtschaftsgesetz) to give the German government more opportunities to review and block certain foreign investments. A few months later, several Chinese companies expressed interest in investing in Osram, a German company making lighting products and semiconductors. The IG Metall trade union said it would block any deal attempt because of the risks that a potential acquirer would "siphon off Osram's technology" and shift production outside Germany (Chazan 2016).

In Southern Europe and Central and Eastern Europe (CEE), by contrast, Chinese FDI is welcomed with open arms. In Greece, the initial Chinese investment by COSCO into the Port of Piraeus in 2008 was viewed with suspicion, fear, and opposition. Today the Greek government is courting China for more investment, especially in its privatization program. In the CEE countries, Chinese FDI is equally welcome, especially, in some cases such as Hungary, where it might provide political leverage against the EU and some of its powerful member states by offering an alternative source of capital.

As a result of these divergences of views, there has been neither uniform, nor unified European response to Chinese investment, even though FDI has legally become a collective competence of the EU since the 2009 Lisbon Treaty (Meunier 2017). Indeed, the EU is

simultaneously negotiating a BIT with China and crafting a new mechanism for screening foreign direct investment at the EU level, but neither can proceed without support from all member states.

### *EU-China BIT*

Since 2013, the EU and China have been negotiating a bilateral investment treaty, the first standalone investment agreement with the EU as a party since the granting of the new FDI competence in the Lisbon Treaty. The investment agreement will replace existing bilateral agreements between China and EU member states. The aim of the agreement is to create a more open, transparent, secure, and reciprocal environment for greater future flows of investment between China and the EU. The most contentious issues include market access, transparency of vetting procedures, and investor protection. China wants assurances and predictability regarding the growing scrutiny of Chinese FDI from European national regulators on grounds of national security and unfair competition. The EU wants easier access to the Chinese market with no obligation to form joint ventures with local partners (García-Herrero et al. 2017).

### Towards a European Mechanism for Vetting Foreign Investment?

In 2017 the EU also launched internal discussions over the creation of a pan-European mechanism to vet inward foreign investment –along procedures inspired by those used in the United States. In February 2017, France, Germany and Italy wrote to the EU Trade Commissioner in order to request a European debate over the conditions under which countries would be allowed to investigate and even block foreign investments, especially in the case of sensitive high-tech products, when the investor is state-owned, and when there is no reciprocal

market access. French president Emmanuel Macron, supported by Germany and Italy, reiterated this demand to have the European Commission examine ways to screen third country investments into strategic sectors at the June 2017 European Council meeting. However, the effort was derailed by an ad hoc coalition of smaller countries and the final, watered-down wording of the summit welcomed an existing Commission initiative to “analyze investments from third countries in strategic sectors” and decided to return to the issue at a later summit (Cerulus and Hanke 2017; Zalan 2017).

Nonetheless, EU Commission President Jean-Claude Juncker went ahead and, in his September 2017 speech on the State of the European Union, proposed an investment screening law that would give guidance to national governments: “If a foreign-owned company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen with transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so we can protect our collective security if needed” (Juncker 2017). Decisions on foreign investments would stay with the member states, but there would be an information sharing mechanism to let other EU states and the Commission know if there are sensitive investments, or acquisitions that could have an impact on other states. The EU executive will be able to screen foreign investments that will likely affect projects funded with EU money designed for research, space or transportation, energy and telecommunications networks (Hanke 2017). This is a first step for France, Germany and Italy, who hope that the EU will eventually move towards a collective mechanism for vetting foreign, especially Chinese, investments.

Divisions among Member States, however, run deep over the issue of how to handle foreign investment, especially investment coming from China. Some of these divisions may have

been exacerbated by Chinese actions, notably the creation in 2012 of the “16+1” initiative, a special forum for cooperation on political and economic issues between China and sixteen European countries –eleven members of the EU and five non-members. Some policy-makers and analysts worry that this strategy is designed on purpose to divide Europeans and weaken the EU. German Foreign Minister Sigmar Gabriel argued, for instance: “If we do not succeed for example in developing a single strategy towards China, then China will succeed in dividing Europe” (Poggetti 2017). Similarly, Franck Proust, a French MEP and the author of a parliamentary report on investment screening in Europe, claimed that “China’s strategy in Europe is divide and rule. [...] And it’s working because the 27 EU member states are incapable to remain in solidarity with each other”(Cerulus and Hanke 2017). As a result, countries dependent on Chinese investment may be reluctant to agree to European collective positions that are critical of China.

## **Conclusion**

Chinese investment has been able to thrive in Europe because the supply of Chinese capital, for reasons internal to China, met the European demand for foreign investment in the wake of the euro crisis. Though FDI from China is overall welcome in Europe and will likely continue, it has posed political challenges and may face greater constraints in the future. In addition to the question of European unity addressed above, several recent political developments have the potential to affect Chinese investment in Europe.

One such development is the Brexit process. Until the 2016 referendum, the United Kingdom had been one of the preferred destinations for Chinese FDI in Europe. Some of the reasons that pushed Chinese investors toward Britain, such as the demand for Chinese

investment in the infrastructure and real estate sectors, will still exist after Brexit. However, the attractiveness of the UK for Chinese investors has derived in large part from its participation in the EU Single Market. A “hard Brexit”, whereby the UK will sever its privileged ties to the Single Market, will likely reduce the willingness of Chinese investors to make acquisitions and greenfield investments there and redirect some of this investment, especially in manufacturing, towards EU countries on the continent.

A second development is the presidency of Donald Trump. On the one hand, the tone of discourse emanating from President Trump has been initially more belligerent towards China in general and the Chinese economy in particular. He may direct his administration to review incoming foreign investments more broadly and thoroughly through the CFIUS process, which the Senate has proposed to reform in a more restrictive direction in a 2017 bipartisan effort, for instance with special provisions for high-technology deals or with an expansion of the CFIUS mandate to include economic factors when assessing foreign takeovers (O’Keeffe 2017). On the other hand, getting more direct investment into the U.S. will be crucial to Trump’s objective of repatriating jobs and of having many products “Made in America” again, and Trump seems to have softened his stance towards China after one year in office. What happens to Chinese investment in the U.S. could have implications for Chinese investment in Europe, which can become a substitute to American acquisition targets in many cases.

A third development is the internal Chinese politics regarding outbound FDI. On the one hand, the recent crackdown on capital outflows as part of the anti-corruption campaign may limit the amount of Chinese investment going to Europe, especially in industries such as sports and entertainment. On the other hand, the recent launch of the “Made in China 2025” policy, coupled with the Belt and Road Initiative, should expand Chinese efforts to invest in Europe. In the short

term, this may accelerate the pace of Chinese investment in Europe and the U.S., especially in sectors with superior technology and know-how, in turn positively impacting the host economies. In the long term, however, increased Chinese investment may enhance the competitiveness of Chinese industry.

Finally, how much Chinese investment Europeans let in will also depend on which other countries are trying to invest in Europe. As other potentially politically problematic countries, such as Russia and Qatar, try to invest in Europe, the desirability of Chinese investment may increase by comparison.

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