Chinese investment in the EU

SUMMARY
From ports to cars to food processing, China's foreign direct investment (FDI) in the European Union (EU) concerns a wide variety of economy sectors. While China's FDI in the EU has grown exponentially, it still is only a small part of the total FDI into EU.

Despite the government's role in the growth of Chinese FDI since 2007, Chinese companies invest abroad in similar ways to other commercial entities. They are investing to gain market share, improve brand recognition and reputation, and find resources and assets. Chinese investors show a preference for investments in the largest western European countries and especially Germany. However, as China's global importance and economic power increases, worries about the possible economic and political consequences of Chinese FDI are also intensifying.

Negotiations on an EU-China bilateral investment treaty were launched in 2013. EU enterprises call for such an investment agreement to ensure more reciprocity in business relationships. Several EU Member States have used different approaches to attract Chinese investment, leading to fears of a "race to the bottom". A single EU-China agreement would remove most of these issues. Chinese entrepreneurs for their part see the different Member State approaches as leading to fragmentation of markets (laws, languages), labour laws and social security, and therefore as a barrier to their effective investment in the EU.

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Towards a bilateral investment agreement

Following the Lisbon Treaty, FDI is now part of the EU's common commercial policy, providing the Commission with the competence to conclude international investment agreements. At the EU-China Summit in November 2013, the two parties launched negotiations on a bilateral investment agreement, with the first round of negotiations taking place in January 2014. The agreement is intended to increase investor protection and market access for companies wishing to do business in both blocs. The EU's objective would be to negotiate a level playing field for foreign investors in China in return for simpler access for Chinese investment to the EU.

For the EU that means moving from a situation with 26 separate investment protection agreements to a single set of standards across the Union. As some EU Member States' existing investment protection treaties with China date from the 1980s they vary greatly.

Currently, in competing to receive FDI, national and sub-national level governments have adopted various schemes, including tax exemptions and welcome schemes. Thus the factors which may attract investments differ from country to country. In facilitating Chinese FDI, national representations and the work of Investment Promotion Agencies (IPA) are of major importance.

The striving of Member States to attract Chinese FDI creates the danger of a regulatory "race to the bottom" with respect to tax advantages or even labour-market conditions in order to put in place the most appealing environment for Chinese investment. The fragmentation of rules and terms applying to FDI also complicates matters for Chinese investors.

Chinese FDI: trends and policy framework

Internal policy framework

Chinese outward foreign direct investment (OFDI) was restricted until the mid-2000s, as the government feared asset stripping and capital flight might occur. Between 1979 and 1990 China initiated its OFDI strategy, adopting specific policies and principles. During the period 1991 to 2000 China elaborated a more detailed system for OFDI. In 1999 it launched the "Go Global" policy to encourage Chinese firms to invest abroad, with the aim of gaining competitive advantage through OFDI strategies and to become more than a generic producer of low-end manufactured goods for Western brands. The government's "Go global" policy together with a stagnant domestic market, the availability of investment capital and reductions in transport costs are reported as...
reasons for the increase in OFDI. In 2007, China Investment Corporation (CIC, China's national sovereign wealth fund) was formed to manage some of the country's foreign exchange reserves. Initially most of its overseas investments were portfolio investments (i.e. stakes of less than 10%), but it has increasingly sought direct investment in companies.

**Trends in Chinese OFDI**

With strong government support, having started from a very low base, China's FDI increased fast, making China the world's fifth largest FDI contributor in 2011. However, China's OFDI stock is still small in comparison to its weight in the global economy. China provides one third of all OFDI invested by emerging market economies.

Annual OFDI flows from China to Europe have increased substantially since 2008. From 2009 to 2010 they grew by 102% as the ongoing debt crisis made the EU an attractive target for Chinese investors. At the same time, the absolute values remain small compared to Europe's total inward FDI stock and to China's entire outward FDI. Of total Chinese outward FDI, about 3.9% was directly invested in the EU in 2010 (see figure 1; more recent figures are not yet available for all EU Member States). It is likely that some of the funds invested in the financial hub Hong Kong and the offshore centres also find their way to the EU.

In 2012, China had provided just 0.7% of total stocks of inward FDI in the EU (corresponding to €26.7 billion). However, this represents a steep increase since 2010, when it totalled only 0.2% or €6.1 billion. In comparison, the US accounted for 39% of total stocks of inward investment in the EU (2012).

**Chinese FDI and the EU**

According to a survey conducted by the European Chamber of Commerce in China, Chinese companies invest abroad to obtain resources (e.g. physical resources, specific skills or expertise), market share, and brand recognition in order to overtake their competition in China. They also seek strategic assets through investment abroad to enhance future competitiveness (ports, airports, logistics, transport). Specifically in the EU, Chinese FDI seeks not natural resources, but brands, operating platforms and technologies as well as market access. Overall, China favours investment in the EU because it is a stable and predictable market.

**Geography**

Geographically, China's OFDI preferences in Europe, similar to other commercially motivated investors, concentrate on the three biggest economies – France, Germany.
and the UK. Germany’s family-owned small and medium-sized companies have been an especially popular target. In addition, Italy, besides its size, is seen as a test market for products adapted to European tastes. And for Belgium, which allows 100% foreign ownership and has no limitations on repatriation of capital and benefits, China has become the second largest trading partner outside the EU.

Mergers and acquisitions are more frequent in western Europe. Member States which have joined the EU since 2004 have received some greenfield investment, with plants or factories established through a larger commitment of capital. This is possibly due to lower labour costs. However, the interest of Chinese investors in eastern European countries has not resulted in substantial investments in the region. Sales and representative offices and distribution centres are the most common entry modes.

**Sectors in focus**

From an early focus on technology, infrastructure and heavy industry, Chinese firms are now growing in strength outside the goods manufacturing sector, by buying companies in the services sector, including healthcare, finance, media and entertainment as well as telecommunications equipment. In the EU, Chinese companies have targeted the manufacturing sector, especially the automotive industry (Volvo in Sweden), industrial machinery (Putzmeister in Germany), information technologies (Huawei) and financial services. It is also claimed that Chinese companies are currently getting involved in infrastructure projects that could provide control over distribution channels in Europe (ports of Piraeus in Greece and Rijeka in Croatia), railways in Slovenia and Hungary, highways in Poland and airports in Germany and Cyprus.

**Views on the potential impact of Chinese FDI**

Despite worries about the strategic impact of China's investment, Thilo Hanemann and Daniel Rosen, in their report, argue that Chinese direct investment in Europe is based on commercial reasons, with political guidance having only a minor impact on Chinese investment in Europe. This view is shared by Lucian Cernat and Kay Paraplies of the European Commission. However, Françoise Nicolas concludes that a systematic approach to regulating inbound foreign investment is needed; this would both prevent protectionism inside the EU and the possibility that some investors one day become a risk to national security.

At the same time, the Chinese government still guides and facilitates overseas investment. Sophie Meunier suggests that in the case of China, where the state owns a controlling interest in many companies that seek OFDI opportunities, these companies are investing to achieve strategic goals.

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**Case study - Volvo**

In 2010 Volvo, a Swedish luxury car brand, was acquired by Geely, the tenth largest carmaker in China from the Ford Motor Company for US$1.8 billion, saving about 16 000 jobs in the EU.

Geely decided to continue building and selling Volvos around the world, as well as to start production and expand sales in China. New factories were built in China and a dealership network was created. Geely is also strengthening its production abroad in Russia, Ukraine, Malaysia and Indonesia.

The Volvo brand has seen its market share decline and profits diminish since acquisition by Geely.

In 2014, Geely announced that it will acquire the British electric car start-up firm, Emerald.

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**Expected benefits**

FDI can increase the welfare of both producers and consumers. It allows firms to explore new markets and opportunities, as well as to operate more efficiently across borders, to reduce production costs, increase economies of scale and promote specialisation. More specifically, for the EU, Chinese FDI provides an influx of capital into the struggling economy and increases employment. In the future, it could make up for diminishing inflows from traditional investment sources like the US.

In addition, it helps to expand European access to China, one of the biggest and fastest growing markets in the world, by creating commercial and personal links with businesses in China. Also European companies acquired may be able to take advantage of the Chinese company's market network. Greenfield projects create jobs that did not exist before, and acquisitions often mean saving a firm that would have collapsed otherwise. According to one study, 45 000 jobs in the EU are associated with Chinese direct investors.

**Possible risks**

Several economic concerns have been expressed in relation to Chinese FDI in the EU. First, it is feared that greater Chinese investment could expose Europe to macro-economic volatility as the volume of Chinese FDI would depend on economic conditions in China. In addition, Chinese firms could eventually move high-value activities acquired in the EU to China, which would entail a loss of jobs and tax revenue in the EU.

When investing in China, European businesses have experienced problems in protecting their key technologies due to copying. This could also be the case where a European business is acquired by a Chinese investor. Finally, there is the possibility of a race to the bottom between EU Member States to attract Chinese investment, and that could have a negative impact on European welfare. This is the main issue that would be resolved by an EU-China bilateral investment agreement.

Some strategic concerns are down to China being a one-party state with values that can be at odds with those of European countries. China could threaten to withhold FDI in order to influence European policies, if EU countries were to become dependent on Chinese investment. In addition, China's specific economic structure might spill over and threaten market-based competition, because state-supported companies in China could operate under different, and possibly preferential, market conditions.

There are security concerns as China will likely become the world's largest economy with the power to influence global security, and as it has aspirations to a greater global role. China has invested in "rogue" countries such as North Korea and Iran. China's OFDI in certain sectors creates the risk of commercial and state espionage and the possibility that dual-use technologies fall into the hands of the of pariah regimes due to such investments.

**European Parliament**

The EP adopted a resolution of 23 May 2012 on "EU and China: Unbalanced Trade?" Among other issues, the EP urged the Commission to negotiate an ambitious and balanced EU-China investment agreement in order to guarantee transparency regarding governance of Chinese companies which invest within the EU, whilst increasing the level of reciprocal capital flows.
On 9 October 2013 it adopted a resolution on the EU-China negotiations for a bilateral investment agreement. It asks the Commission to negotiate an agreement that would ensure equality of investment environments, a level playing field and fair competition between Chinese state-owned enterprises and EU private companies. Furthermore, the resolution urges the inclusion of binding clauses on social responsibility, social and environmental standards, intellectual property rights and data protection, but to exclude cultural and audiovisual services from the negotiations on market access.

Main references


Endnotes

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