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EU-CHINA BILATERAL INVESTMENT RELATIONS: HOW CAN THE EUROPEAN UNION DEAL WITH THE CHINESE INVESTMENT OFFENSIVE?

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Abstract:

China and Europe are two global economic powers and essential parts of the international value chain. Companies on both sides are interested in taking advantage of the opportunities offered by the European and Chinese markets in the form of creating jobs, inducing innovation, and extending their markets. China's rapid development has benefited greatly from the capital, technology, and know-how of European companies. For EU companies, China is no longer only an important location for the production of intermediate goods and raw materials, a supplier, or sales market, but it is also considered of great importance as a research and development location.

The main aim of this paper is to examine EU-China investment relations. In the first part of our work, we will focus on the overall view of the development of Chinese FDIs in the EU and vice-versa. Then, we will deal with the distribution of Chinese FDIs in the EU according to member states and economic sectors. In the last part, we will discuss the main concerns between Brussels and Beijing regarding the Chinese investment offensive on Europe and its consequences for both sides. In this respect, we focus on a new EU-level screening framework implemented mainly against Chinese investments in Europe.

Keynotes: China, European Union, Foreign Direct Investments, Portfolio Investments.

1. Introduction

Karl Marx's well-known statement, ironically, may explain the present tension in economic relations between China and the European Union resulting from the Chinese trade and investment offensive in Europe. As Marx observed in the 19th century, "A spectre is haunting Europe—the spectre of China. All the powers of old Europe have entered into a holy alliance to exorcise this spectre."

China and Europe are two global economic powers and essential parts of the international value chain. Companies on both sides are interested in taking advantage of the opportunities offered by the European and Chinese markets in the form of creating jobs, inducing innovation, and extending their markets. China's rapid development has benefited greatly from the capital, technology, and know-how of European companies. For EU companies, China is no longer only an important location for the production of intermediate goods and raw materials, a supplier, or sales market, but it is also considered of great importance as a research and development location.

It is generally known that international capital movements follow two main streams: Foreign Direct Investments (FDIs) and portfolio investments. In the case of FDIs, investors' main intention is to produce goods and services in host countries. FDIs can be divided into the following groups according to the purpose of investors: natural resource-oriented investments, domestic market-oriented investments, world market-oriented investments, and efficiency-oriented investments. Another group of FDIs may be classified in accordance to their operations in the receiving country: green field investments, brown field investments in the form of cross-border mergers and acquisitions, and joint- ventures.

The main aim of this paper is to examine EU-China investment relations. In the first part of our work, we will focus on the overall view of the development of Chinese FDIs in the EU and vice-versa. Then, we will deal with the distribution of Chinese FDIs in the EU according to member states and economic sectors. In the last part, we will discuss the main concerns between Brussels and Beijing regarding the Chinese investment offensive on Europe and its consequences for both sides. In this respect, we focus on a new EU-level screening framework implemented mainly against Chinese investments in Europe.

2. China's Diversified Investment Strategy

The Chinese government put its 13th Five-Year Plan for National Economic and Social Development of China for 2016–2020 in force in March 2016. This new development plan has been regarded as one of the most important milestones of Chinese economic development.

The main objectives of this new ambitious plan are twofold:

Firstly, the 13th Five-Year Plan, referred to as the "New Normal," aims to increase the economic growth rate and per capita income both in rural and urban areas, thus creating an innovative economy with the promotion of private sector participation while balancing the role of the government and the market.

Secondly, China's 13th Five-Year Plan aims not only to implement the "Made in China 2025" initiative, with the target of becoming a global manufacturing powerhouse by reducing its dependence on foreign technology imports,[1] but also promoting technological R&D activities to raise the share of R&D expenses in GDP to 2.5% by 2020.[2]

One of China's main tools to establish an innovative economy while upgrading its manufacturing industry is inward- and outward-oriented FDI. Therefore, it is argued that China's interests in FDI both at home and in Europe are manifold—from access to new and modern technologies, high-tech assets, and the transfer of knowledge, to broader commercial access to the European market and entrance into third markets (such as the United States, Latin America, Africa) over European corporate networks. Chinese investors are looking for brand names to improve marketability of their products—both at home and abroad.[3]

Among the things that Chinese investors seek in Europe are: [4]

- Integrated regional and global value chains in production, knowledge and transport;
- A stable legal, regulatory and political environment, particularly in a context of global disruption and political uncertainty;
- Political/diplomatic influence in a region that in aggregate terms remains the second largest economy after the US.

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[1] The 'Made in China 2025' strategy of 2015— a master plans for China's economic transformation and catching up its manufacturing industry with Western countries. The Plan has targets for ten industries, including advanced information technology, automated machine tools and robotics, aerospace and aviation equipment, maritime engineering equipment and high-tech vessels, advanced rail equipment, energy-saving vehicles and new energy vehicles (NEVs), electrical equipment, agricultural machinery and equipment, new materials, biopharmaceuticals and high-performance medical devices. The latest version of the 'Made in China 2025' strategy added new industries in January 2018, such as telecommunication, railway, and electrical power equipment robotics, high-end automation, and new energy vehicles by 2025. See Anna Saarel, "A new era in EU-China relations: more wide- ranging strategic cooperation?" European Parliament, Brussels, http://www.europarl.europa.eu/RegData/etudes/STUD/2018/570493/EXPO_STU(2018)570493_EN.pdf.A new era in EU-China relations, 28.

[2] China relies heavily on state support for innovation and is continuously increasing its R&D volume. In 2017 Chinese spending on R&D amounted to 2.1 % of total GDP, as compared to 2.8 % for the U.S., 2.9 % for Germany, and 3.3 % for Japan. Ibid.

[3] Valbona Zeneli , **"**Mapping China's Investments in Europe," The Diplomat, March 14, 2019, https://ediplomat.com/2019/03/mapping-chinas-investments-in-europe/.

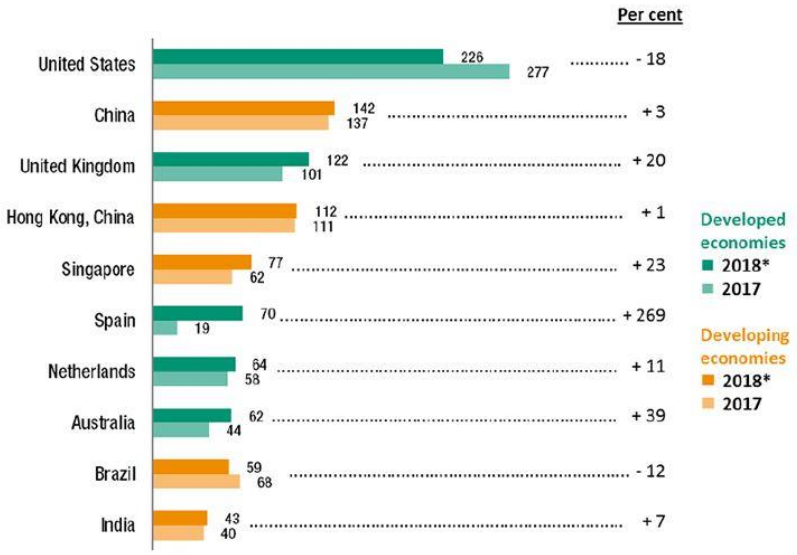
[4] Chinese Investment in Europe: A Country Level Approach. Edited by: John Seaman, Mikko Huotari, Miguel Otero-Iglesias, https://www.merics.org/sites/default/files/201801/171216_ETNC%20Report%202017_0.pdf

3. Global Foreign Direct Investment: Composition of Worldwide FDIs

Figure 1 shows that the United States remains the largest recipient of FDI, despite its inflows decreasing 18 percent to 226 billion USD between 2017 and 2018. China remains the second largest FDI recipient in the world. Meanwhile, the United Kingdom surpassed Hong Kong to become the third biggest recipient of foreign direct investment. China attracted a record of 142 billion USD worth of FDI in 2018, up three percent from the previous year, according to UNCTAD's latest Global Investment Trends Monitor.

Figure 1:

Figure 3. FDI inflows: top 10 host economies, 2017 and 2018*
(Billions of US dollars)



Source: UNCTAD.
* Preliminary estimates.

Source: Global FDI inflows in 2017 and 2018. *UNCTAD https://gbtimes.com/china-remains-second-largest-fdi-recipient-in-the-world*

3.1. Foreign Direct Investments in China[5]

According to the 2018 World Investment Report, China is one of the most attractive investment locations for foreign investors. FDI inflows to China continued to increase between 2016 and 2018, from 133 billion USD to over 136 billion USD, reaching almost 142 billion USD by the end of the year.

[5] https://en.portal.santandertrade.com/establish-overseas/china/foreign-investment.

The rapid growth of FDIs in China can be explained by three factors: the improving open-door policies for foreign firms, the rapid development of the high-tech sector, and the establishment of free trade zones.

The share of Chinese FDIs in Europe, at 2.2 percent, remains low relative to the United States' 38 percent. Similarly, EU countries held only four percent of the total FDI in China in 2016, versus 36 percent of the total FDI in the United States.[6]

FDI stocks in China reached 1,627 billion USD in 2018. In 2017, Hong Kong (72.1%) was the largest investor in China. Singapore (3.6%), the Virgin Islands (3.0), South Korea (2.8), Japan (2.4%), the United States (2.0%), the Cayman Islands (1.6%), the Netherlands (1.6%), Taiwan (1.3%), and Germany (1.1%) were other major investors. Interestingly, most of the FDIs in China originate from neighboring countries and from the "Chinese Diaspora" settled outside of mainland China.[7]

The leading investing countries outside of the EU were the Netherlands and Germany in 2017. The U.S. share of total FDI is still very low. Germany is the largest European investor in the technology businesses operating in China.[8]

By 2017, more than 8,200 German enterprises were operating in China, representing a total investment of 67.34 billion USD. Investments were mainly oriented toward manufacturing (25.5%), computer services (15.9%), real estate (12.8%), leasing business and services (12.7%), wholesale and retail trade (8.7%), financial intermediation (6.0), scientific research (5.2%), transport (4.2%), electricity (2.6%), and construction (1.9%) in 2017.[9]

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[6] Valbone Zeneli , ibid. Valbona "Mapping China's Investments in Europe."

[7] The new negative list was put in force on July 28, 2018, consisting of prohibited and restricted industries for foreign investment. The new Negative List reduces the number of restrictive measures from 63 in the previous version to 48. The new free trade zone negative list, "The Special Administrative Measures for Foreign Investment Access to Pilot Free Zones," reduces restrictive measures from 95 in the previous version to 45. See Saarel, "A new era," 39.

[8] According to the BDI report on China, German industry uses the latest environmentally friendly technologies, efficient in use of both energy and raw materials, in the Chinese market and contributes significantly to the creation of high-quality jobs and the training of qualified specialists in China. German companies have contributed to the unprecedented rapid expansion of an efficient infrastructure (express train network, airports, power generation and transmission, mobile phone network, health industry). See "China – Partner and Systemic Competitor: How Do We Deal with China's State-Controlled Economy?" BDI Policy Paper on China, Policy, January 2019, Berlin, 6.

[9] FDI inflows to the high-tech sector have been rising significantly and currently account for almost one-third of total inflows. For instance, Samsung is investing 7.2 billion USD to expand its production line of memory chips in Xi'an. In 2016, Apple made a one billion USD funding deal with Didi Chuxing, and in 2017 Japan's Soft Bank, along with other companies, contributed to a 5.5 billion USD funding round for Didi Chuxing as well. See "China Foreign Investments," Santander Trade Portal, https://en.portal.santandertrade.com/establish-overseas/china/foreign-investment.

4. EU-China Foreign Direct Investment

The 20th round of the EU-China investment agreement negotiations took place in Brussels from February 25–27, 2019. They asserted that such a treaty should guarantee investment protection and improve market access for EU companies in the Chinese market.[10] However, the negotiations, which began in 2013, are improving very slowly. The treaty is intended to replace the 26 existing "Bilateral Investment Treaties" (BITs) between China and EU member states.[11]

4.1 Chinese Foreign Direct Investments in the European Union

FDIs in the EU have increased by almost 50 in the past eight years. Total Chinese investment in Europe, including mergers and acquisitions (M&A), as well as green-field investments, now amount to 348 billion USD, and China has acquired more than 350 European companies over the past ten years.[12]

The EU is the main destination for FDI in the world: FDI stocks held by third country investors in the EU amounted to 6,295 billion EUR at the end of 2017.[13]

Concerning China's capital exports to developed and emerging economies, an interesting research paper has been published by the Kiel Institute for the World Economy on the topic of "Chinese Overseas Lending." The paper gives renewed information on capital exports in the form of trade loans, FDIs, and direct loans from China to the rest of the world (Figure 1).

According to the author's estimate, even Germany is heavily indebted to China's central bank. China holds around 370 billion USD in German bonds. This amounts to ten percent of Germany's GDP. For the Eurozone as a whole, China holds 850 billion USD in bonds, which corresponds to seven percent of the Eurozone's GDP.[14]

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[10] The issues under negotiation include investment market access and protection; a regulatory framework for investment, including transparency, licensing and authorization procedures, sustainable development, and dispute settlement. See Saarel, "A new era," 13.

[11] See for full text of the "Report of the 20th round of negotiations for the EU-China Investment Agreement," EUROPEAN COMMISSION Directorate-General for Trade Brussels, March 1, 2019, TRADE.B2. with China, http://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157772.pdf. (Note: Ireland does not have a BIT with China, while Belgium and Luxembourg have a joint treaty). At the beginning of 2016, an agreement was reached defining the scope of the agreement.

[12] V. Zenelli, "Mapping China's investment."

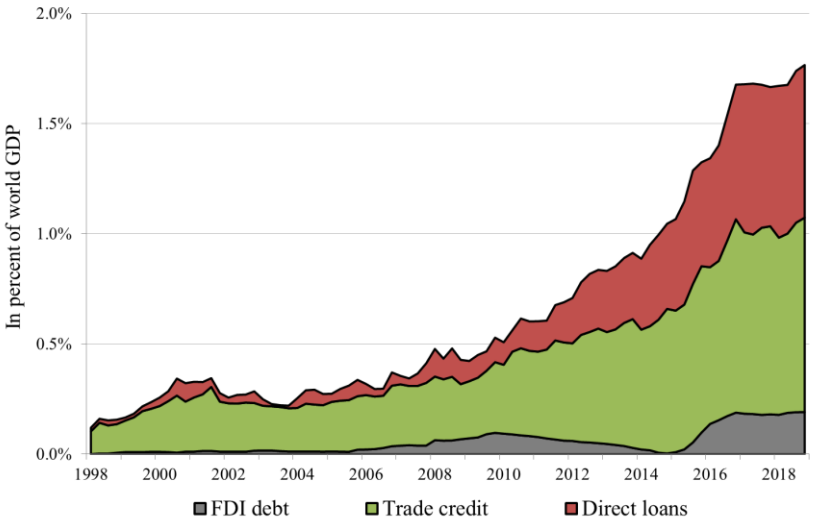
[13] European Commission - Press release, "State of the Union 2017 - Trade Package: European Commission proposes framework for screening of foreign direct investments", Brussels, 14 September 2017 http://europa.eu/rapid/press-release_IP-17-3183_en.htm.

[14] In addition to debt securities held as foreign exchange reserves, China's International Investment Position reports portfolio holdings outside of the central bank (194 billion USD in 2017). The bulk of this foreign portfolio debt is held by state-owned banks such as the Bank of China, the Agricultural Bank of China, the China Construction Bank, and the Industrial and Commercial Bank of China. In recent years the geographic composition of these investments can be inferred from China's report to the IMF's Coordinated Portfolio Investment Survey. As of 2017, more than half of these holdings were bonds issued by the U.S. and other advanced countries: 23 percent were issued by offshore financial centers, 15 percent by Hong Kong and Macao, and five percent are debt securities of developing and emerging markets. See Sebastian Horn, Carmen Reinhart, and Christoph Trebesch, "China's

The resulting estimates suggest that China holds at least 1.4 trillion USD of the U.S. Treasury agency and corporate bonds (equivalent to seven percent of U.S. GDP) and around 190 billion USD of UK bonds (seven percent of the UK's GDP).

When calculated as a share of total outstanding sovereign bonds, China is estimated to hold around six percent of all U.S. Treasury bonds, 17 percent of all German government bonds, and around six percent of all UK sovereign bonds.[15] The Chinese state is thus a major player in the global market for trade credits, with large amounts lent to advanced economies.

Figure 2: China's Overseas Lending Boom



Note: This figure shows a subset of outstanding Chinese overseas debt claims as reported in China's BoP Statistics, scaled by global GDP. Trade credit includes short- and long-term trade credits and advances. FDI debt claims arise in case of inter-company lending across borders. Portfolio debt is excluded. (Source: PBoC and IMF.)

Source: Sebastian Horn, Carmen Reinhart, and Christoph Trebesch, "China's Overseas Lending," Kiel Working Paper, No. 2132, Kiel Institute for the World Economy, 2019, 3.

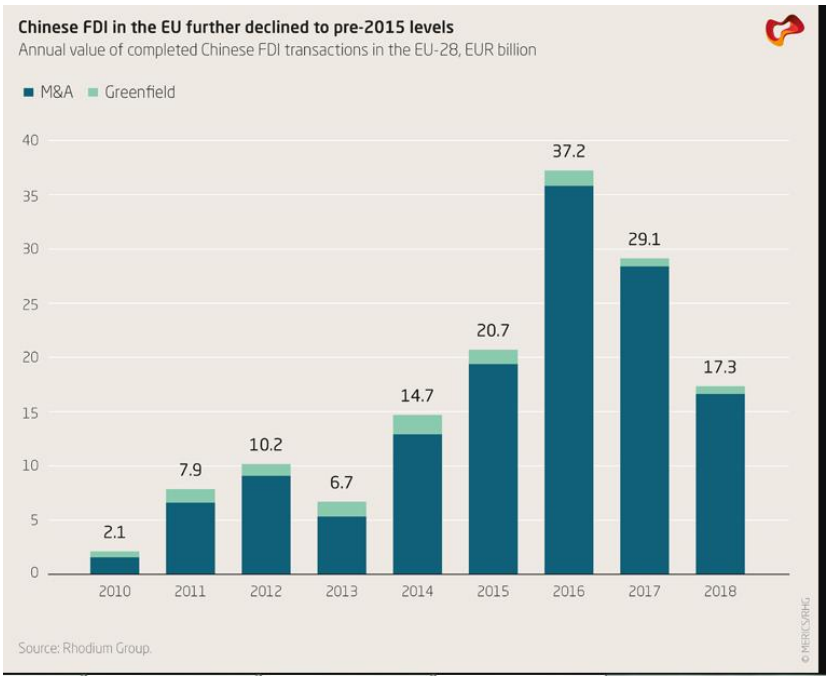
Overseas Lending," Kiel Working Paper, No. 2132, Kiel Institute for the World Economy, 2019, https://www.treasury.gov/resource-center/data-chart-center/tic/Pages/ticsec2.aspx

[15] Furthermore, China holds approximately 30 billion USD of bonds issued by emerging markets, in particular by Brazil, Indonesia, Malaysia, Mexico, Poland, and South Africa. This amount is a small share of China's total reserves, but it is substantial from the perspective of these debtor countries. See Horn, Reinhart, and Trebesch, "China's Oversea Lending," 34.

4.2. Chinese Foreign Direct Investment in the EU: A Decreasing Trend Since 2016

Figure 3 demonstrates that Chinese FDI in the EU has increased almost fifty-fold in only eight years, from less than 840 million USD in 2008, to a record high of 45 billion USD (37 billion EUR) in 2016. Since then, this number has started to decline, and in 2018, Chinese firms engaged in FDI transactions in the EU worth 17.3 billion EUR, which represents a decline of 40 percent from 2017 levels and over 50 percent from the 2016 peak of 37 billion EUR.

Figure 3: Chinese Outbound FDI



Source: Rhodium Group Chinese investment in the EU CHINESE FDI IN EUROPE: 2018 TRENDS AND IMPACT OF NEW SCREENING POLICIES, Merics, March 2019.

Chinese investors target Europe's strategic assets and research and development networks, with the largest and wealthiest European countries attracting the greatest investment.

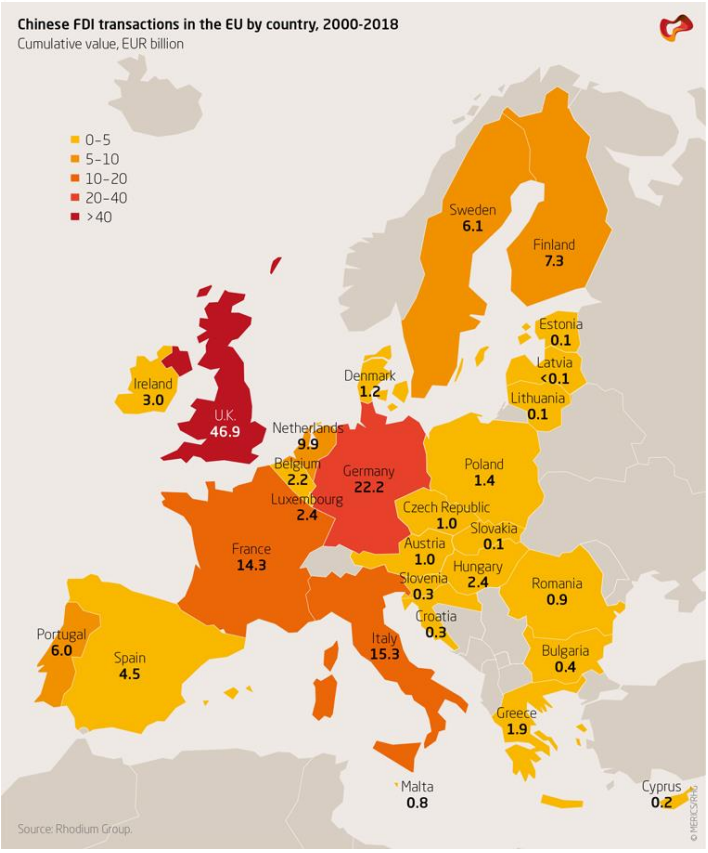
Two basic factors have played an important role in the decrease of China's FDIs in Europe: first, strict capital controls and tightening of liquidity as well as the Chinese government.[16] The second is the September 2018 European Commission proposal, made upon request of three countries (Germany, France, and Italy), that proposed

[16] China's new rules, which were put in to effect on March 1, 2018, will restrict domestic companies' outbound overseas investment. According to the new regulations, the monitoring of outbound investments will no longer be subject to pre-transaction 'verification' and 'record-filling' or reporting procedures, even for overseas projects worth over 300 million USD. However, projects involving sensitive countries, regions, or industries continue to be subject to a verification procedure. Restrictions apply to domestic companies' outbound FDIs in certain sectors such as real estate, hotels, entertainment, and sports clubs, while indicating support for investments in natural resources and along the Belt and Road corridors. See Saarel, "A new era in EU-China Relations," 39.

new legislation to establish a Common European Framework for screening FDI in the receiving countries.

The legislation focuses on strategic assets that are critical to European security and public order, including foreign acquisitions of critical technologies, infrastructure, or sensitive information.[17]

Figure 4:



Source: Thilo Hanemann, Mikko Huotari, and Agatha Kratz, “A report by Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS),” March 2019, https://www.merics.org/sites/default/files/2019-03/190306_MERICS-Rhodium%20Group_COFDI-Update_2019.pdf.

4.3. The Distribution of Chinese FDIs in the EU According to Member States

Figure 4 shows the distribution of Chinese FDIs among EU member states between 2000 and 2018. According to the map, the United Kingdom (46.9 billion EUR) and Germany (22.2 billion EUR) hold the largest portion of Chinese FDI and appear to be the most preferred countries in the EU in terms of cumulative value between 2000

[17] V.Zenelli, ibid,“Mapping China's Investments in Europe.”

and 2018. These two countries have been followed from a distance by Italy (15.3 billion EUR)[18] and France (14.3 billion EUR).

There is another group of countries that draws great attention from Chinese investors, the Netherlands (9.9 billion EUR), Finland (7.3 billion EUR), Sweden (6.1 billion EUR), Portugal (6.0 billion EUR), and Spain (4.5 billion EUR). Within the remaining member states, the share of Chinese investments varies, with in 3 billion EUR in Ireland, 2.4 billion EUR in Hungary, and 1.9 billion EUR in Greece.[19]

Chinese investments in the Central and Eastern European countries, including the Baltic States, represent a small percentage compared to the core EU countries. The EU's periphery countries seem to be unattractive to Chinese investors because of insufficient infrastructure, lack of capital accumulation, lower economic growth rates, and serious unemployment rates.

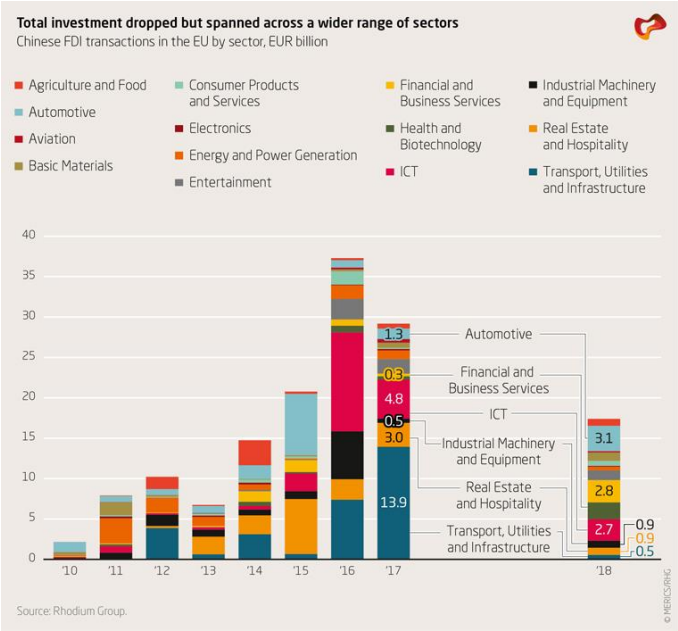
In 2018, the distribution of Chinese FDIs in the EU appeared as follows: The United Kingdom (4.2 billion EUR), Germany (2.1 billion EUR), and France (1.6 billion EUR) continue to receive the most attention, but their share in total Chinese FDI declined from 71 percent in 2017 to 45 percent in 2018. Two newcomers made it to the top five list, Sweden and Luxembourg, propping up the relative shares of Northern Europe and Belgium, the Netherlands, and Luxembourg (Benelux) in total investment.

[18] In 2015, China's acquisition of Pirelli made Italy the top destination of Chinese FDI in Europe, giving China access to one of the most important car tire manufacturers globally and an entry into the replacement market—a segment, until recently, dominated by the major European and Japanese brands. See Pirelli's acquisition by Chem China, Insead, Knowledge:

https://knowledge.insead.edu/node/3919/pd

[19] The share of state-owned companies in total Chinese investment in Europe has declined from 80 to 90 percent between 2010 and 2012 to an average of around 50 to 60 percent in the past five years. In 2018, the weight of SOEs declined again to 41 percent of aggregate investment, the second lowest level on record. See Thilo Hanemann, Mikko Huotari, and Agatha Kratz, "A report by Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS)," March 2019, 13.

Figure 5



Source: Thilo Hanemann, Mikko Huotari, and Agatha Kratz, "A report by Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS)," March 2019, https://www.merics.org/sites/default/files/2019-03/190306_MERICS-Rhodium%20Group_COFDI-Update_2019.pdf.

4.4 Chinese Investment Distributed Across a Greater Variety of Economic Sectors

Figure 5 indicates the distribution of investment across economic sectors. With fewer mega deals, Chinese capital was spread more evenly across sectors compared to 2016 and 2017. Investment declined in transport, utilities and infrastructure, and real estate. The biggest increases were recorded in financial services, health and biotech, consumer products and services, and automotive.[20]

4.5 Protection of the EU Against the Chinese Investment Offensive to It: FDI Screening Framework

The rapid increase in Chinese investments in the EU caused great concern among its members, especially in the big nations. *The Economist* drew attention to the

[20] The UK was the top recipient again, with 4.2 billion EUR of completed transactions (driven by Chinese consortium Strategic IDC's investment in Global Switch and Huadong Medicine's acquisition of Sinclair Pharma). Germany came third, totaling 2.1 billion EUR of investment (including Kerui Tiancheng's takeover of Biotest and Ningbo Jifeng's acquisition of Grammer), and France fifth, with about 1.6 billion EUR in Chinese investment (including Beijing Sanyuan Foods' acquisition of St Hubert and CITIC's acquisition of Axilone Plastique). See Hanemann, Huotari, and Kratz, "A report by RHG and MERICS," 10.

present situation in an article titled “China’s Design for Europe: the Chinese Government’s Divide and Conquer Policy.”[21]

The great Chinese offensive led to economic unrest in the EU. As a result, in September 2017, European Commission President Jean-Claude Juncker reacted with the statement, “…we want Europe to keep the most open investment regime in the world, but we must defend Europe's strategic interests and for that we need scrutiny over purchases by foreign companies that target Europe's strategic assets…”[22]

Following this statement, a policy was approved by the European Parliament on February 14, 2019, the result of three-way talks between the European Parliament, the Council, and the Commission that concluded on November 20, 2018.

The European Framework for the Screening of Foreign Direct Investments “will allow Member States and the Commission to cooperate and exchange information on investments from third countries that may affect security or public order in the EU.”

Interestingly, the legislation focuses on strategic assets that are critical to European security and public order, including not only foreign acquisitions of critical technologies, infrastructure, or sensitive information but also a wide range of sectors from energy, transport, and artificial intelligence to finance, water supply, health, and the media (Table 1 in Appendix).[23]

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[21] “China’s Design for Europe: the Chinese Government’s Divide and Conquer Policy,” *The Economist*, October 6, 2018.

[22] European Commission - Press release, “State of the Union 2017 - Trade Package: European Commission proposes framework for screening of foreign direct investments,” Brussels, September 14, 2017, http://europa.eu/rapid/press-release_IP-17-3183_en.htm.

[23] The new framework:

- creates a cooperation mechanism where member states and the Commission will be able to exchange information and raise concerns related to specific investments.
- allows the Commission to issue opinions when an investment threatens the security or public order of more than one member state or when an investment could undermine a project or program of interest to the whole EU, such as Horizon 2020 or Galileo.
- encourages international cooperation on investment screening, including sharing experience, best practices, and information on issues of common concerns.
- sets certain requirements for member states that wish to maintain or adopt a screening mechanism at national level. member states also have the last word in whether a specific investment operation should be allowed or not in their territory.
- takes into account the need to operate under short business-friendly deadlines and strong confidentiality requirements.

The Regulation will enter into force once the Council also give its approval. After that, member states and the Commission will have 18 months to put in place the necessary arrangements for the new mechanism to operate. Currently, 14 member states have national screening mechanisms in place. Although they may differ in their design and scope, they share the same goal of preserving security and public order at the national level. Several member states are in the course of reforming their screening mechanisms or adopting new ones.

See, “Commission welcomes European Parliament's support for investment screening framework,” European Commission - Press release, https://europa.eu/rapid/press-release_IP-19-1052_en.htm.

The new EU investment screening framework aims to slow down and control Chinese investors. The EU regulation directed member states to specifically review state-supported investments in sensitive technologies and critical infrastructure. These criteria could cover a large share of Chinese M&A activities in Europe. We estimate that 82 percent of Chinese M&A transactions in Europe in 2018 would fall under at least one of those criteria.[24]

The current debates indicate that some European leaders would like/are considering reforms in other areas, as well, including export controls for dual use and critical technologies, data security and privacy rules, procurement rules, and competition policy.

Finally, the EU and China have recognized the importance of having access to a rules-based, predictable system for resolving disputes linked to investments. A multilateral system for the resolution of investment disputes—a permanent multilateral investment court—is under consideration.[25]

5. Conclusion

China, along with the EU and the U.S., is one of the greatest economic powers in the world and an integral part of the global value chain. In the last forty years, China has followed a world market-oriented development strategy and accumulated a huge amount of official reserves, accounting for around 3 trillion USD. By definition, the current account surplus can be balanced in two ways: capital outflow in the form of FDIs/portfolio investments or increasing official reserves held in hard currency by the Central Banks. Due to the rapid growth in Chinese export revenues, China's expansionary investment policy inside or outside its country was predictable.

China follows a pragmatic policy, not an ideological one. The Chinese government is planning for the long term, and on the way, its strategies/policies can be renewed/changed to reach these ambitious long-term goals. System competition with China is forcing Europeans to think more comprehensively, strategically, and with a patient and long-term approach.

EU member states have witnessed this fact but were too delayed in their reaction. Now, the EU, mainly big member states, face growing challenges posed by China and its state-led economy.

If we look at the experiences of other East Asian countries in the economic development process, such as Japan, South Korea, Taiwan, and Singapore, it seems that China will follow the same development patterns and continue to give the first priority to completing economic development activities under the authoritarian regime by using gradualist policies. Once successful, it will pay more attention to democratic and liberal reforms.

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[24] Hanemann, Huotari, and Kratz, "A report by RHG and MERICS," 13.

[25] Saarel, "A new era," 15.

Over the last 40 years, almost 6 million students studied at U.S. and European universities and most of them returned back home, to China- a country, which forms part of international value chain following world-market oriented development strategy.

According to the China National Tourism Administration, Chinese tourists travelled overseas on 131 million occasions in 2017 alone. Naturally, China cannot isolate and protect itself from political and economic changes taking place around the world.

Contrary to expectations that China will not change in a radical way and would not fully implement the fundamental principles of Western democracies in the foreseeable future.

China will transform its political structure and yield democratic values to some extent gradually. The more expected progression would be for Beijing to turn into a nation with democratic values yet maintaining its "Chinese Heritage", in keeping its cultural national identity same as Japan, South Korea and Singapore today.

As BDI President Kempf pointed out, "The People's Republic is establishing its own political, economic and social model, and the country has entered into systemic competition with liberal market economies such as Germany. This development must be realistically accepted by the EU and a realistic response must be developed."[26] In other words, there is no way out other than to meet China's economic challenges and compete. In short, we have to accept this as a fact of life.

The EU's basic economic problem is that the European Union is divided into three groups of economies: big nations (Germany, France, the UK, Italy, Spain, and the Netherlands), which account for 80% of GDP, and the other 22 middle- and small-sized economies, which cannot compete with China by themselves.

The trade and investment activities of Chinese businesses are mainly involved in the five big countries (Germany, France, the UK, Italy, and the Netherlands), and the role of the rest of the member states may be described in economic terms as more or less insignificant.

Consequently, it is easier for China to have an impact on periphery member states and separate them from the big nations. Instead of following isolated economic policies, EU members must be fully unified and make the EU economy strong enough to compete with China as a single entity. As long as the level of economic development in the EU varies greatly within the Union, it seems it will be difficult for the EU to meet the economic challenges stemming from China.

In consideration of these facts, in its policy paper, the BDI calls for a strengthened economic policy framework for the European single market. In order to make Germany and greater Europe fit for innovation, especially in competition with China, both basic research and applied research, development, and education must be strengthened.

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[26] BDI Policy Report on China, https://english.bdi.eu/article/news/strengthen-the-european-union-to-better-compete-with-china/.

The key words here are the deepening of the economic and monetary union; the strengthening of research, innovation, and industry; the further development of the internal market; the orientation of the EU budget toward growth, cohesion, and external strength; and the expansion of the digital economy.[27]

The answer to the following question will determine the EU's future relations with China: Will the EU decide to protect itself from the Chinese trade and investment offensive through defensive and restrictive trade and investment policies as the U.S. did, or will it strengthen its economy and promote high-tech sectors in order to compete with China as a strong and united Europe?

In order to find the rational answers of all these questions, The European Union has decided to discuss the main economic and political issues with Chinese counter partners under German EU-Presidency with participation of 27 member states in Leipzig in Summer 2020.

[27] [27] BDI Policy Report on China Ibid.,11.

APPENDIX: TABLE 1

National-level screening mechanisms and changes since 2017

No regime · Regime in place but no change · Newly established regime · No regime but considering change · Regime in place and updated

Country	Year of change	Status quo, recent or upcoming changes
Austria		The Ministry of Economic Affairs has to review and approve acquisition of 25 percent or more of a controlling interest by non-EU, non-EEA and non-Swiss persons in an Austrian enterprise engaged in "protected sectors" including defense, telecommunications, energy, water supply, hospitals, traffic infrastructure and education.
Belgium		
Bulgaria		
Croatia		
Cyprus		
Czech Republic		Considering setting up a dedicated mechanism or strengthening investment review.
Denmark*		Considering setting up a dedicated mechanism or strengthening investment review.
Estonia		
Finland		Ministries of Trade/Industry and Defense approve foreign investments. If they consider "important national interests" to be jeopardized, ministries defer the decision to the Council of State.
France	2018	In November 2018, a new decree in France expanded the list of sensitive sectors in which foreign investments are subject to review and approval by the Ministry of Economy. The list now includes areas such as cybersecurity, artificial intelligence, robotics and semiconductors as well as space operations. Further legal changes are expected in 2019 (with the relevant law, "Plan d'Action pour la Croissance et la Transformation des Entreprises," currently still under review)
Germany	2017/ 2018	In July 2017, the German federal government adopted amendments to its Foreign Trade and Payments Ordinance in order to allow for wider control of foreign corporate takeovers with a focus on critical infrastructures. In December 2018, German authorities further changed investment screening rules so as to review any transaction in which a non-European foreign company plans to buy more than ten percent of a German firm in sectors such as defense, critical infrastructures and the media.
Greece		
Hungary	2018/ 2019	In October 2018, the Hungarian government adopted new regulations that require investing companies with non-EU shareholders to obtain government approval before acquiring assets in national security-related areas, including dual-use technologies and critical infrastructures.
Ireland		
Italy	2017	In October 2017, Italy's cabinet passed a decree to strengthen disclosure requirements for foreign investors acquiring significant stakes in Italian companies and expanded the "golden powers," under which transactions in certain strategic sectors can be vetoed, to "high-tech" companies, such as those dealing with data storage and processing, artificial intelligence, robotics, semiconductors, dual-use technology, and space/nuclear technology.
Latvia	2017	In March 2017, Latvia strengthened its investment policy related to national security, establishing a mandatory review mechanism for transfer of ownership in companies and facilities "with significance to national security," or in national and European critical infrastructures.
Lithuania	2018	In January 2018, the parliament adopted an updated version of the "Law on Enterprises and Facilities" to require notification and facilitate vetting of investments in certain economic sectors or in certain protected zones.
Luxembourg		
Malta		
The Netherlands	2018	The Dutch government is considering adopting a sector-specific foreign investment control regime. Debates about and legislative proposals for the telecommunication sector have advanced the most, but other sectors involving vital infrastructure might follow.
Poland		In addition to approval requirements in specific sectors, foreign investors planning to buy a stake of 20 percent or more in a so-called strategic Polish company need approval from the Ministry of State Treasury. The Council of Ministers maintains a list of strategic companies that can be amended by regulation.
Portugal		Portugal maintains a general safeguard clause in its investment regulation that requires an assessment of compliance with statutory requirements and preconditions established under Portuguese law for non-EU investments that could affect public order, security and health.
Romania**		Romania is listed in several EU documents as not having a screening mechanism in place, but the Supreme Defense Council can review referred mergers and acquisitions for potential threats to national security after notification from the Romanian Competition Council.
Slovakia		
Slovenia		
Spain		Foreign investors need to obtain prior approval by the Council of Ministers in defense sector, gambling, broadcasting and air transporation. The Council of Ministers can also intervene on an ad hoc basis if investments affect, or may affect, public powers, public order, security or public health-related activities.
Sweden		Considering setting up a dedicated mechanism or strengthening investment review.
UK	2018/ 2019	In June 2018, the UK government expanded its powers to review M&A transactions. The "share of supply test" was amended and turnover thresholds for review have been lowered from GPB 70 million to GPB 1 million for military, dual-use and advanced technology (computing, quantum technology) sectors. A significantly broader and dedicated national security M&A regime is expected to come into force in 2019.

Source: MERICS and Rhodium Group research.

Source: Thilo Hanemann, Mikko Huotari, and Agatha Kratz, "A report by Rhodium Group (RHG) and the Mercator Institute for China Studies (MERICS)," March 2019, https://www.merics.org/sites/default/files/2019-03/190306_MERICS-Rhodium%20Group_COFDI-Update_2019.pdf.