

PERSPECTIVE

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China's Investments in Europe: Lessons for South East Asia

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EXECUTIVE SUMMARY

- China invests its savings surplus abroad, buying foreign companies, including European ones.
- One option when operating in Europe is to do so through the European Union (EU), which can be cumbersome and time consuming.
- A second option is to deal with individual member states. Their transfer of sovereignty to the EU, however, limits the room of manoeuvre, and it is not in China's interest to sow discord within the EU.
- Europe weighs the potential benefits of Chinese investments against threats to jobs and loss of ownership. Member states may welcome investment projects, but there are common EU policies in place to maintain solidarity and limit risks to their security.
- The European experience may be useful for Southeast Asian countries and ASEAN^[1] to consider.

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^[1] Association of Southeast Asian Nations.

ECONOMIC INTERDEPENDENCE

The core of economic globalization is that the overall balance of payments and investment balance paints a picture of a country's economic strength or weakness. Multilateralism is a key concept underpinning growth and prosperity. However, the European Union (EU) – like the US – analyses trade and inward and outgoing direct investment with China in a bilateral context.^[2]

The EU acknowledges the reform of the Chinese economy, but suspects that the opaque workings of the Chinese economy allow the state to subsidize exports. The role of the State Owned Enterprises (SOE) throws doubt into the mindset of European policy makers whether they are dealing with enterprises comparable to what is seen at home or whether the Chinese government is pulling levers behind the scene. These doubts explain the European hesitation to classify China as a market economy as defined by the World Trade Organization (WTO). Granting such a status to China would reduce the EU's leverage to defend its economic life in case China uses its economic structure to bend the rules or rather interpret the rules differently from the EU stance.^[3]

In China's perspective, its growing exports are nothing more than a reflection of comparative advantages, and attempts by the EU to slow down Chinese trade penetration into Europe is interpreted as deliberate distortion of market forces. Chinese direct investment reflects a savings surplus which necessarily looks for investment abroad. China does not see any conceptual difference between what it is doing now and what Britain did in the early days of the British Empire and the US in the years after 1945. Since the economic reforms started in 1979, China has integrated well into the global economic system set up by the US and Britain in the immediate post-World War II years. And China plays the multilateral card.

Both EU and China strive to seek mutual benefits. More often than not, it has been possible to avoid adversarial situations. But they watch each other. The EU fears dumping in the trade area plus attempts to play member states against one another in the investment sector. China is determined to get a role in Europe's economic life and worries about meeting closed doors just because 'it is China doing it'.

EU AND CHINA

EU sees China primarily as an economic competitor – and economic partner – and not as a rival or challenger in the global power game. Cases where vital interests collide are difficult to spot. EU's emphasis on human rights has from time to time created tensions, but not derailed amicable links. Both parties are determined to entertain a dialogue about this sensitive topic. Climate change/global warming are shared concerns and the Paris

^[2] Francois Godement and Jonas Parello-Plesner with Alice Richard, "The Scramble for Europe", *ECFR*/37, July 2011.

^[3] Francois Godement, "The EU-China Summit: Searching for common ground", *ECFR*, 01st June, 2017.

agreement signed by both has been made a virtue from this common position. Statements by the Trump administration and lack of commitments to free trade at international meetings are in contrast to the strong positions by China's leaders about its wish to play a prominent role in defending the system.^[4] EU and China nurture ambitions to take over the role as defenders of the existing institutionalized economic globalization – as status quo powers.

In the geopolitical framework, the Atlantic Alliance obliges the EU to be cautious in its China policy so that its actions are not interpreted as strengthening China's hand vis-à-vis the US. The low attention giving to geopolitics explains why the Atlantic Alliance only impeded progress once and that was in 2005 when US exercised pressure on the EU not to lift the arms embargo on China introduced after Tiananmen 1989.^[5]

China's EU-policy is steered by two goals at the same time. Priority number one is to keep EU in the geopolitical game as a potential partner. A weak or even more so a collapse of the EU will unavoidably strengthen US and Russia, in China's perspective. As the US and Russia are seen as rivals potentially threatening vital Chinese interests, a comparatively strong EU is in China's interest. The complexity of EU decision-making may perplex China which is used to dealing with European nation-states. Gradually as China gets to know how the EU works, it will be able to strike the right balance between directly influencing EU-institutions and indirectly swaying member states' voting pattern to achieve a decision in conformity with Chinese interests. This is a delicate balance, as too heavy-handed an approach can be counter-productive. Getting it wrong would create suspicion about China and jeopardize its economic expansion in Europe.

APPROACHING INDIVIDUAL MEMBER STATES

The most striking example – and a recent one – of China using its influence on individual member states came in July 2016 when the Permanent Court of Arbitration in The Hague ruled in favour of The Philippines against China about control over disputed waters in the South China Seas (SCS). It took the EU three days to publish a vague statement not going further than acknowledging the ruling.^[6] Allegedly, Greece and Hungary opposed stronger language sought by Britain, France, and Germany.^[7] Both these countries are recipient of big Chinese investments with the sale of the port of Piraeus in Greece a signature case of incoming investment at a time and on a scale that makes the recipient sensitive to the creditor's view. It came as a surprise that China would go to such lengths to interfere, especially recalling that EU is not directly involved in the SCS dispute. It is even more surprising that it was done in a foreign- and security policy case with no implications for economic relationships. The EU and member states might chew on whether this is a one-off case or an omen of strong reactions to come if EU-members receiving investments fail to comprehend what China regards as its crucial interests.

^[4] “Full Text of Xi Jinping keynote at the World Economic Forum”, *CGTN*, 17. January 2017.

^[5] “EU Wavers on Plan to lift Arms Embargo on China”, *Los Angeles Times*, 23. March 2005.

^[6] Declaration by the High Representative on behalf of the EU on the Award rendered in the Arbitration between the Republic of the Philippines and the People's Republic of China, *European Council Press Release 442/16*, 15/07/2016.

^[7] “EU statement on South China Sea reflects divisions”, *Reuters*, 15. July 2016.

The European Commission in 2008 started to investigate accusations that China dumped steel on the European market and concluded in 2013 that evidence was sufficiently strong to prepare plans that would allow higher import duties. 14 member states opposed this move. Among them was Britain. This position attracted attention for several reasons. The Port Talbot Steelwork in Wales, the largest steel producer in Britain, was struggling and its future uncertain, which led some observers to believe that higher import duties would have helped to preserve jobs. Almost at the same time, the British government was in full swing trying to attract Chinese investment to Britain including the City of London; these efforts culminated in president Xi Jinping's state visit in October 2015. Without firm evidence to support such a view, there was suspicion that the British position was influenced by concerns of negative repercussions on the broader strategy vis-a-vis China.^[8] What may have made the course of events more complicated was that Port Talbot Steelworks had been bought in 2007 by Tata, an Indian company.

Chinese investments in Europe lags far behind the US – and other investors – but the picture is changing fast, auguring China as a major investor in a few years' time. China's Overseas Direct Investment (ODI) going to Europe reached an all-time high in 2015 standing at EUR 20bn, bringing the size of its ODI stock in Europe to USD 54bn. Mergers & Acquisitions (M&A) influencing ownership is growing so fast that the EU is the largest recipient of China's transactions in this sector of capital movements. The expansion has attracted attention as has several investments in view of the size of Chinese investments or fear of Chinese buying of enterprises of strategic importance. In Germany the sale of Kuka, an industrial robot maker, raised concerns about the transfer of technology deemed to be important for Germany's competitive advantage in this sector. The sale of Aixtron, a chip equipment maker, was blocked by the German government for national security reasons. In Britain, Prime Minister Theresa May in summer 2016 temporarily blocked the Hinkley Point C nuclear power station partly financed by China allegedly due to Britain's energy security considerations.^[9]

The acquisition of the Greek Port of Piraeus in September 2016 was and still is regarded as an economic and commercial transaction, possibly related to the Belt and Road Initiative (BRI). The acquisition may, however, have been inspired by the number of Chinese citizens caught in Arab countries bordering on the Mediterranean when the Arab Spring broke out in 2011. In Libya alone, 38,000 Chinese citizens had to be rescued, triggering the largest operation of this kind undertaken by China.^[10] This is a kind of investment with dual purpose capabilities – commercial ones and potentially serving national security purposes.

The EU's Common External Trade Policy did not until the Lisbon Treaty of 2009 embody investment, which explains why member states (except Ireland) have Bilateral Investment Treaties (BIT) allowing China to deal with them separately instead of via EU institutions.

^[8] "Is the UK calling for EU duties for Chinese steel?" *Full fact*, 22nd July 2016 + "British steel: UK Government blocked EU plans to allow tougher tariffs on 'aggressive' Chinese imports", *The Independent*, 31 March 2016.

^[9] Jerker Hellstrom, "China's Acquisitions in Europe, European Perceptions of Chinese Investments and their Strategic Implications", FOI, December 2016.

^[10] Jonas Parelló-Plesner and Dr Mathieu Duchâtel, "*China's Strong Arm: Protecting Citizens and Assets Abroad*", Chapter 5, IISS, the Adelphi Series, 2015.

In 2015, the European Commission proposed to plug this hole through an EU Investment Treaty replacing the existing national ones. Such a treaty would level the playing field and curb the possibility of China playing member states against one another.^[11] Paragraph I,2 of the EU-China Strategic Agenda for Cooperation says ‘Negotiate and conclude a comprehensive EU-China Investment Agreement that covers issues of interest to either side, including investment protection and market access’, which underlines the importance both parties give to investment flows – not forgetting Europe’s substantial investments in China.^[12]

President Emmanuel Macron of France raised at the meeting on 22-23 June 2017 of the European Council the topic of screening foreign investment into the EU to protect strategic interests. The discussion revealed that even if the idea resonates with feelings in member states, there are hesitations of how far to go. Several countries that are beneficiaries of Chinese investment projects resisted strong wording, leading to a not very ambitious phrase in the conclusions, welcoming “the Commission’s initiative to harness globalisation and, inter alia, to analyse investments from third countries in strategic sectors, while fully respecting Members States’ competences. The European Council will revert to this issue at one of its future meetings.”^[13]

One puzzling case is that of membership in the Asian Infrastructure Investment Bank (AIIB) launched by China in 2014. 17 members of the EU have joined, but without prior EU coordination to establish a common position as is often done in international negotiations. Nor has there been any serious analysis of whether EU institutions like the European Commission and the European Investment Bank (EIB) should be represented, as is the case with the European Bank for Reconstruction and Development (EBRD). Depending on how far and how fast the AIIB develops, this could prove to be a costly oversight or omission.^[14]

On the initiative of China, a framework has been set up for cooperation between China and 16 Central and Eastern European nations, five of which are not members of the EU. It is not perfectly clear what the purpose is and how China intends to use this forum. In view of five of the partners not being EU member states, it looks unlikely to be an attempt to bypass EU-institutions. It is more likely a case of traditional Chinese diplomacy, e.g. Shanghai Cooperation in Central Asia, and possibly also an instrument to further the Belt and Road Initiative (BRI), which might explain setting up an investment fund to the tune of USD 11bn.^[15]

^[11] Francois Godement and Angelaa Stanzel, “The European Interest in and Investment Treaty with China”, *ECFR*, 2015.

^[12] http://eeas.europa.eu/archives/docs/china/docs/eu-china_2020_strategic_agenda_en.pdf

^[13] European Council Meeting (22-23. June 2017) – Conclusions, *EUCO* 8/17, Brussels 23. June 2017 + EU Free Traders water down Macron’s plan to vet foreign takeovers, *Financial Times*, 24. June 2017.

^[14] “The Asian Infrastructure Investment Bank”, *European Political Strategy Centre*, 24. April 2015.

^[15] Kerry Brown, “China’s Geopolitical Aims: The Curious case of the 16-plus-1”, *The Diplomat*, 03 May 2017.

China has expressed an interest to establish a 5+1 cooperation with Nordic countries. This could be explained by interest in the Arctic plus the BRI.^[16] Similar ideas have been floated for a 6+1 platform with China and six Southern European countries.

CONCLUSION AND LESSONS FOR ASEAN

China's stock of capital invested in Europe is still small, but the EU feels a growing pressure and a degree of uncertainty about the motives underpinning Chinese investment. Mergers & Acquisitions are monitored both by individual countries and the EU institutions. The EU institutions have started to set up frameworks and procedures to transfer monitoring of Chinese investments from member states to the EU level. There is awareness that China may use its future economic clout to acquire strategic assets and enterprises, interfere in EU decision making by making smaller member states in particular dependent on its investment projects, and attempt to play member states against each other. The EU institutions and member states seem to agree that the problem is not what China is doing, but what China as the world's largest saver might do in the future. EU's dilemma is to enter into a closer economic relationship with China without risking strategic assets or allowing China to undermine EU solidarity.

Whether this can be done successfully depends to a large extent on China whose geopolitical interest in EU must be reconciled with trade and investment priorities. If China activates too obvious policies to bypass EU rules or search for short term benefits disregarding long-term trust, EU-China relationship may be endangered. Both look on themselves as no pushover and both expect respect from those they do business with.

So far both have acted in conformity with Deng Xiaoping's words "cross the river by feeling the stones", but there have been a few cases of raised eyebrows signalling that missteps may occur.

China is a more important investor for ASEAN than for the EU.^[17] From 2013 to 2015 the share of Foreign Direct Investment (FDI) coming from China has risen from 5.1 percent to 6.8 percent. Considering that some Chinese investments probably go via Hong Kong, the share can be as high as 9.3 percent and 10.6 percent into the ASEAN region.^[18]

China is fast setting up institutional frameworks to facilitate much higher investment flows into the region. AIIB, BRI, and the New Development Bank (NDB) formed by the so-called BRICS (Brazil, Russia, India, China, and South Africa) inspired by China – will be used as a vehicle for Chinese investment in Southeast Asia, supplementing government to government and the private sector initiatives.

[16] "Sino-Nordic Relations: Opportunities and the Way Ahead", *Institute for Security and Development Policies*, 2016.

[17] Over the three year period 2013-2015 FDI to EU from China was broadly speaking unchanged at around 1.3 percent of total FDI. Source: Foreign Direct Investment, EU 28, 2012-2015, Table 1, *Eurostat*, .Link: http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Foreign_direct_investment,_EU-28,_2012%E2%80%932015_YB17.png.

[18] Foreign Direct Investment Statistics, ASEAN, February 2017, Table 27. Link: http://asean.org/storage/2015/09/Table-27_oct2016.pdf

Southeast Asia is used to receiving large scale FDI, but flows from main creditors – EU, US, and Japan accounting for around 40 percent (2015) – have rarely been seen as a potential threat to strategic interests or linked their posture on foreign- and security questions. The European experience confirms, what has already been seen in Southeast Asia, that the same cannot be assumed for Chinese investments. The proximity to China, its growing economic weight and the Southeast Asian countries’ interest in receiving investment means that it is for China to gauge how fast and how deep a link between FDI and influence it can look for without risking a backlash.

The crucial point for Southeast Asian countries and ASEAN is to figure out whether they are disposed to signalling this awareness that China should tread softly and if so whether they want to use a kind of ASEAN approach. If handled adroitly lines may be drawn respecting Southeast Asian countries’ interests. The ace up their sleeve is that while they may be beneficiaries of Chinese FDI, so is China a beneficiary of its investment in this part of the world – economically and politically.

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