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## Should Europe limit Chinese investment?

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One of the defining features of the EU is its open economy, considered to be one of the fundamental pillars supporting Europe's high level of socioeconomic development. As a result, the EU has always been very receptive to foreign direct investment and its Member States actively compete among themselves to attract such investment. This positive vision of foreign investment as an engine of economic growth is so widely held that only 12 of the 28 Member states have established mechanisms for supervising (and potentially rejecting) foreign investment on the grounds of national security.

Nevertheless, in February 2017, the Economy Ministers of Germany, France and Italy sent a joint letter to the Commissioner for Trade, Cecilia Malmström, requesting the establishment of **a mechanism to supervise foreign investment** at the European level.

Two months later, the European Popular Party sent a letter with the same request to the President of the

European Commission, Jean-Claude Juncker, who took the baton and proposed the creation of such a mechanism during his State of the Union address in September 2017.

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Why would such a European mechanism to supervise investment be necessary at this time? The main reason is the extraordinary evolution in recent years of Chinese investment in Europe, which grew from €1.6 billion in 2010 to €35 billion in 2016. Given that the current stock of Chinese investment internationally is equivalent to barely 10% of its own GDP, investment from China into Europe still has significant future potential for growth. Nevertheless, such a response is not really motivated by this quantitative aspect. In fact, European countries continue to compete amongst themselves to attract more investment from the Asia giant. The controversy arises more from the potential strategic, security and other public order implications of such investment. Therefore, this debate should not isolate itself in any one country, nor be understood as a protectionist measure, especially in the current context in which the role of Europe, as one of the principal guarantors of the open and inclusive international order, is particularly necessary.

A central issue in this controversy is how Europe should deal with investments in strategic sectors from actors who do not follow market rules. In this respect, Chinese investment has generated suspicions when it has been made in technology companies, especially if their activities are linked, or could be linked, to security and defence, or to critical infrastructures. This type of Chinese investment in Europe has grown exponentially since the Eurozone crisis, and has concentrated on the purchase of technology companies in the largest European economies, and in critical infrastructures

in the southern and eastern countries of the EU. These operations have been facilitated by the preferential access to finance that is granted to these companies by the Chinese state, in turn giving China access to high technology and political influence.

These acquisitions of technology companies, aided by Chinese public finance, facilitate China's positioning as a competitor in the high value-added industrial sector, which China is also stimulating with programmes like China 2025, the transfer of dual-use technologies for military development and efforts to access sensitive information. With respect to political influence, a

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demand for finance makes some EU countries more receptive than others to the political interests of Peking, a stance which has on various occasions in the past weakened the coherence and unity of the EU. For example, this happened with the decision of the Permanent Court of Arbitration on the South China Sea in July 2016. Furthermore, something similar occurred in June 2017, at the UN Human Right Commission, when Greece vetoed an EU condemnation of the Chinese regime's human rights record.

The foreign investment supervisory mechanism that is now being articulated by the European Commission aims to: (1) increase the transparency of investments that potentially could affect security or public order; (2) raise consciousness of potential strategic implications of foreign investment, especial in Member States that do not have their own investment supervision mechanisms; and (3) to allow the EU to supervise investments linked to projects which its institutions have financed. To achieve these objectives, the Commission draft proposes a mechanism based on cooperation between the Commission and the Member states, beginning with exchange of information. This mechanism would not compel Member States to establish their own investment supervisory organisms nor would it grant the Union the capacity to block foreign investment in its Member States. The legislation is therefore looser and more flexible than that which is already in effect in a number of the Member States and other members of the G7.

**Spain** has its own tools, in line with the criteria of the Commission, allowing it to suspend the investment freedom principle. This does not mean, however, that implementation of the Commission's proposal would not also have positive effects for Spain. The dissemination of information that such a mechanism would impose would also allow Spain access to early advanced information on foreign investments in other EU countries that might have a direct impact on it. Therefore, should there ever be another case like that of Three Gorges becoming the principal shareholder of Energias de Portugal (EDP) –which also gave the Chinese company control of EDP Spain– such information would arrive in Madrid well before the deal would be consummated.

It is not yet entirely clear how this foreign investment supervisory mechanism will be implemented, although this is expected to be announced by the European Council before the end of the year. The process during this time will involve reconciling the opposed interests of different public and private actors. On the one hand, there are differences between Member states like Germany, France and Italy which support the establishment of more restrictive instruments and more competencies for the Commission, and those

who want to minimise the possibility that such a mechanism might be used in a protectionist manner that could reduce the flows of FDI toward their countries. On the other hand, within different Member States, security and public order interests are pitted against private interests that wish to sell corporate assets.

It remains to be seen whether a European investment supervisory mechanism will be finally approved, and what scope it might have. For the moment, the working proposal is based on information sharing and a maintenance of Member State veto capacity over investment operations. This working proposal also seems to provide for a reasonable balance between the multiple competing interests at play.