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Investment Openness in Europe: Investment Screening and Implications for EU-China Investment Relations

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Access to the Chinese market is critical for many European businesses, and all the more so if they operate in knowledge-intensive industries such as mechanical engineering, transport equipment and chemical products. Accordingly, exports to China are an important source of skilled jobs in Europe's high value-added sectors. What holds for the EU is equally true for China. Chinese exports are also dominated by knowledge-intensive industries, with positive effects on value chains and competition in the EU. At the same time, non-discriminatory access of Chinese companies to the European market supports millions of jobs in China. It also allows Chinese companies to scale and transition to high-value added production. These are, obviously, mutual benefits documented by spectacular growth rates for trade in both directions. Europe was China's most important export market in 2017 (imports worth EUR 375 billion EUR) and the second most important source of imports (exports worth EUR 199 billion).

Trade between the EU and China is increasingly driven by direct investment and the integration of complex value chains. Outsourcing activities and access to one of the world's largest consumer markets are the most important drivers for EU businesses investing in China. Since a number of years, EU companies investing in China have increasingly been targeting more strategic sectors. These often include sensitive parts of the value chain, e.g. the production of knowledge-intensive intermediary and final products as well as research and development activities. On the other hand, Chinese companies' investment in the EU is usually long-term, driven by many factors including brand reputation, access to technology, technology cluster effects and, after all, better access to more than 500 million European consumers.

Unfair treatment still is a serious problem for European companies investing in China. As in many emerging market economies, market access conditions in China do not guarantee fair and equitable treatment. By comparison, EU regulations are much less discriminatory, particularly in the area of ownership restrictions. Chinese ownership policies force European companies into joint ventures. Considering, for example, the cumulative value of FDI transactions from 2000 – 2017, 55% of investment by German carmakers in China was invested in joint ventures in which companies were only permitted to own a minority stake of 49% or lower. By contrast, due to the EU's commitment to equitable treatment, Chinese companies in the EU's automotive sector now almost exclusively hold controlling ownership stakes. There is no doubt that Chinese investors benefitted from favourable market access conditions in the EU – and EU governments keeping their hands off their business.

Political hostilities towards Chinese investors need to transition to better modes of cooperation, legal certainty and greater levels of market access. Allegations about dangerous sell-outs of European technology fan political concerns but are seldom anchored in reality. Chinese investors do not tear apart European companies or "steal" European technology. Nevertheless, EU policymakers are pushing legislation for the screening of foreign direct investment with Chinese investment being the major source of concern. In many Member States, policymakers share the belief that European technology is at risk, if Chinese investors take stakes in successful European companies. There are, however, important reasons why investment screening needs to be conducted with great care.

First and foremost, investment screening can easily become a tool that is used for unfair discrimination of Chinese investors, and if Europe misbehaves there is a clear risk that investment openness in China for European firms will shrink. Moreover, investment screening can impact on the distribution of political power among EU Member States. There is a risk – one perceived by smaller Member States – that a mechanism for investment screening can serve as a tool for larger countries to exercise power against smaller countries. In an attempt to shield domestic companies or national industrial policymaking, the governments of larger Member States may want to exert political influence over smaller countries regarding the selection of 'favourable' or the rejection of 'unfavourable' investors. The EU needs to make sure that the mechanism cannot be hijacked and that its use is based on objective criteria and actual necessity. Arbitrary enforcement practices would severely undermine a system of fair and equitable treatment. It would be difficult for the EU to mandate countries like China to undertake reforms that have not happened within the EU first. Multilateralism, after all, starts at home.

The design of the EU investment screening framework needs to focus on protecting the integrity of the EU's overarching economic policy objectives. State-ownership is a key issue because many Chinese companies have close ties to Beijing. The injection of features of state capitalism into European economies would stand in opposition of the EU's trade and internal market policies. In its relations with China, the EU needs to insist on an open and non-discriminatory investments and trading system. Progress in the negotiations of the EU-China Comprehensive Agreement on Investment (CAI) and a clear commitment to multilateralism are preconditions to levelling the playing field between local and foreign competitors in China.

The EU should seize the current moment of opportunity to push China to open up further and to become a fair and open market. How stringent the investments screening will be applied in the EU will be the central issue in the future. Enforcement practices will feed back on Chinese investors' decisions on where to invest in the EU's Single Market and China's treatment of EU investors at home. Against this background, the focus in EU-China investment relations should go beyond discussing new barriers in the EU, but rather about seizing opportunities to open the Chinese market.

In the context of the proposal to establish an EU investment screening framework and the ongoing negotiations of the EU-China investment agreement, ECIPE in cooperation with the Mechanical Engineering Industry Association (VDMA) organised a discussion with stakeholders on the threats and opportunities of Chinese investments in European technology and European investments in China in September 2018. This bulletin is based on stakeholder opinions expressed during this discussion, as well as subsequent stakeholder consultations conducted by the authors.