European Institute for Asian Studies

Event Report

China's Investments in Europe

EIAS Briefing Seminar

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China's robust economic growth and rapidly expanding economic presence are evident in the accelerated development of the BRI, the growing involvement in the investor-state dispute settlement system, and its FDI outflows exceeding FDI inflows since 2016. This indicates a positive future for Chinese investments in Europe, however one should not forget the obstacles along the way.

Namely, the slowdown of Beijing's economy to the slowest rate since the global financial crisis, the scrutiny over the peripheral reforms of the pivotal industrial policy tool guiding foreign investments in China, and the upcoming debates on reforming the investment dispute settlement system. In the coming years, these issues are likely to challenge the robustness of the bilateral investment relationship between China and the EU.

Welcome speeches by

Mr Axel Goethals, CEO, European Institute for Asian Studies (EIAS)

Mr Axel Goethals opened the conference by addressing the key trends in Chinese investments: the steady relationship with Europe based on mutually beneficial investment environment, and the general decline of outwards investments in the last few years followed by growth in 2018. He highlighted that amidst increased scrutiny over multilateralism, global trade and investments, this event should function to foster greater understanding of China's role as a new, natural partner of the EU. Furthermore, Mr Goethals underlined the importance of looking beyond the BRI initiative, urging greater attention be payed to the many jobs and flourishing economy created by Chinese investments in the last decade.

Panel discussion

Prof Dr Jun Xiao, Wuhan University, Hubei Province

Prof Dr Xiao opened his speech by commenting on various legal issues that he argued have dire consequence for Chinese investments in Europe. He explained the importance of addressing this, given that there are many unanswered questions surrounding substantive and procedural rules on all three levels of legislation – national, European, and international.

Prof Dr Xiao started by explaining that there has been intense debate around the reform proposed by the European Union to the Investor-state dispute settlement (ISDS), and in particular, the investment court system (ICS). The issue is natural considering the ongoing negotiations between China and the EU, and the possible inclusion of a multilateral investment clause.

For clarification, ISDS currently works by allowing foreign investors to turn to private arbitration tribunals rather than public courts in cases of unfair treatment with regards to investments in host countries. This mechanism only allows for foreign companies to sue states, not the other way around, and also doesn't allow for domestic companies to sue states. There is significant public opposition to ISDS due to its potential to allow corporations and big enterprises to sue governments when regulations have a negative impact on their investments, thus lowering standards and interfering with legislation.

There is also the incentive for the arbitrators to rule in favour of foreign investors because they are the ones who can initiate new cases and thus reappoint the arbitrator again. Another problem with the arbitrators is that they have no sovereign legitimacy and are not accountable to the public. Lastly, ISDS disputes are paid out of taxpayers' money.

Prof Dr Xiao continued by explaining how China's attitude towards ISDS is not easy to pinpoint, but it is evident that Beijing clearly has an interest in ISDS since Chinese investments abroad need the protection of ISDS. Additionally, China's general interest in the dispute settlement mechanisms doesn't prevent it accepting possible reforms. Illustrative of its increased involvement in ISDS, China began to offer a broad and innovative range of ISDS services since 2015. This includes the creation of new Chinese courts to handle possible investment disputes, and the formation of joint arbitration centres within regions in which there are heavy Chinese investment flows (e.g. Africa).

In cases where Chinese investors are claimants, claims had failed because of the restrictive provisions of the relevant Chinese Bilateral Investment Treaty (BIT). In other words, there have been no detrimental consequences for China, yet, on the contrary, the need for ISDS and its reform grows.

Additionally, Prof Dr Xiao elaborated on the design and structure of the ICS and highlighted that one should understand ICS not only as an issue of international law or the academic world, but also as a political matter. ISDS has two fundamental and invariable features, namely the standing tribunal and the appeal mechanism. Officials of the standing tribunal have to address potential conflicts of interest and the mechanism members deal with more tentative questions. Generally speaking, the mechanism has two functions: a) promoting consistency of decisions; b) correcting errors. However, there is significant difficulty in identifying wrong decisions, due to the generally embodied treaty provisions that are a natural part of bilateral relations.

Therefore, as a potential modification, Prof Dr Xiao considering subordinating the two functions of the mechanism. This way the problem of inconsistency will be eliminated partially, as currently, the fact that different tribunals only hear particular cases each time and interpret investment protection standards differently is in turn harming the credibility of the system.

Questions remain concerning the legal authority of the mechanism in correcting the decisions of the tribunal. First of all, it should be made sure that there is no difference in qualification of the tribunal and the mechanism's members, ensuring that they can identify properly in the first place what the states have or have not committed to. The first reason for the legal authority derived in such a case, will be the close relationship between consistency of decisions and their predictability. With this, Prof Dr Xiao firmly stated that the ICS proposal made by the EU is a step in the right direction and has evident efficiencies.

Lastly, he made a short comment on the type of relations – bilateral or international – and how it affects the characteristics of the ISDS. On the bilateral level, the consistency is not greatly affected by the mechanism, because the membership is small and stable in comparison with ad hoc tribunals. In such cases, a one-tier tribunal system is enough. On the international level, the two-tier tribunal system proposed by the ICS seems impractical due to numerous reasons including the financial burden, and the possible damage to consistency and coherency due to the large membership in the decision-making process.

Thus, Prof Dr Xiao instead suggested a more practical option: the formation of a standing multilateral body which combines the advantages of the tribunal and mechanism, and that tries to find remedies for the downsides of the existing system. Finally, Prof Dr Xiao asserted that he hopes that this will contribute to the consistency, predictability, and most importantly the legitimacy of the investment dispute settlement body.

Prof Dr Jing Bi, Chinese Academy of International Trade and Economic Cooperation

Prof Dr Jing Bi's presentation discussed the policy practice of China's international investment agreements and the prospect for investment cooperation between China and the EU under the framework of China-EU FTA. She argued on behalf of China's great determination and confidence in speeding up reforms concerning the international investment climate. Prof Dr Jing Bi claimed that China's policy is adapting against the backdrop of changing international practice and illustrated this claim with the reforms in the 1990s, which gave more access to foreign investors in China and instigated the revision of more than 3000 laws and regulations in preparation for the accession to the WTO.

Prof Dr Bi elaborated on the Catalogue for the Guidance of Foreign Investment Industries, which is a pivotal industrial policy tool guiding foreign investments in China. It was released in 1995 and it classifies foreign investment into four categories for purposes of market access of foreign investment in China, these are: allowed, encouraged, restricted, and prohibited. The catalogue is revised every year to encourage the process of opening up.

While the new Catalogue from 2017 opens a number of new industries to foreign investment such as the automobile sector, many key industries such as banking and telecommunications remain highly restricted. Even services classified under the category "encouraged", which benefit from special incentives such as reduced tax rates, may still be subject to restrictions. Thus, the relaxations are not as ambitious as many investors have anticipated and fall short of expectations.

Even so, Prof Dr Bi argued that the changes taking place are illustrative that the ongoing reform is gradual, yet genuine, and that they represent more than simply tentative steps. The biggest progress can be observed in the so called Special Administrative Measures on Access to Foreign Investment, known also as "the Negative List". While in 2013, around the time of the opening up of the Shanghai Free-Trade Zone, 119 special amendments and measures were issued, last year the number was solely 45. This is a decrease by more than 76% and it demonstrates that regulators are becoming more proactive in terms of China's openness to the rest of the world.

Lastly, Prof Dr Bi pointed out three steps that have the potential to speed up China – EU negotiations: transforming the political will of both sides into comprehensive negotiations; resolving the investment dispute reforms; and China opening further up. In conclusion, she noted that treatment and opening up should be reciprocal and one should not forget the long way China has come through in terms of reforming in the last 40 years.

Mr Chen Min, General Representative, China Chamber of International Commerce

Mr Min opened his remarks by commenting on the multinational law firm Baker McKenzie's report which elaborated on the announced Chinese mergers and acquisitions, reaching $22bn in Europe and $2.5bn in North America in the first half of 2018. The report thus argued that Chinese investments in Europe are becoming far more robust than the those in North America.

While Mr Min agreed that the report has valuable and objective remarks, he stated that after examination it's difficult to reach the same conclusions as those of the authors. The impression that the reader gets is that Chinese investments in Europe are shocking, while the research is not comprehensive enough since it concentrates solely on M&A and it omits important investments in sectors like infrastructure. Ergo, the comparison is not convincing.

Next, Mr Min made a prediction on China's investment tendencies in Europe, putting aside the report, and analysing push factors. He identified two factors that may have negative consequences for the investment flow from China to Europe, and three that foster an investment-friendly climate in the eyes of the enterprises.

The former includes the rise of protectionism in Europe - insurgent political forces foster a more conservative and aggressive environment in some European states. Simultaneously,

European unity is challenged by international threats and challenges to the EU's agenda. This presents a narrative of an unstable investment environment, which is not encouraging for Chinese companies.

In addition, there are obstacles from the Chinese side as well – a major one being the slowdown of Beijing's economy to 6.5 per cent, the slowest rate since the global financial crisis. The government pointed out reasons for this, including the weaker industrial output and the severe international situation. With less currency to sponsor FDI investments, there is a possibility that this will be an obstacle to external expansion. This may not be good news for Europe, but it's not necessarily bad news for China.

Analysts from Forbes have argued that domestically, the slowdown makes possible the transition to a higher value-added production, resulting in generally improved living standards - rising wages and stronger domestic consumption. Additionally, the GDP growth rates present only one part of the picture: 10 per cent GDP growth in 2010 brought an additional $606 billion to the economy while 6 per cent growth in 2017 brought $1,202 billion. Thus, the slowdown should not worry investors and host countries too much as it is not the main factor that determines investment's destinations.

The positive factors Mr Min outlined included China's proactive approach when it comes to the Belt and Road Initiative. Pan-Eurasian infrastructure development is still in its infancy and it is expected to foster more investments from both sides. Next, as policy is waiting on deal-making, it is no surprise that the ongoing Sino – US trade dispute represents an incentive to shift Beijing's attention from Washington to Brussels. Mr Min made the remark that sometimes protectionism is good since it sends investors away, in this case towards Europe. Lastly, despite the fact that most of the FDI outflow is connected to state-owned enterprises, Mr Min stated that private sector investments abroad are steadily growing, which may lead to a significant increase the number of investments in Europe in the coming years.

To conclude, Mr Min predicted that the rate of Chinese investments in Europe will remain stable.

Dr Duncan Freeman, Research Fellow, the College of Europe

Dr Freeman opened his remarks by elaborating upon the broader picture of China – EU investment relations. He pointed out that investments do not encompass solely trade, but even more importantly FDI flows. When it comes to investment inflows, China has developed a policy to attract FDI since the 1990s and it has become a relatively significant

destination since then. Concerning outflowing investments, in the past it was the norm that investment flows travelled from developed to developing countries, however since the 1990s, a number of developing countries have emerged as important investors, such as China. More significantly, there has been a very significant increase in outgoing Chinese investment in the past years, with Chinese FDI outflows surpassing inflows in 2016.

Dr Freeman reached the same conclusion as Mr Min – comparatively speaking, that FDI flows between China and Europe are not as shocking and robust as they seem. Dr Freeman suggested that in order to achieve a more comprehensive picture of Chinese investments into Europe, one might also note the investment flows from Hong Kong, which reached €91 billion in 2016.

Finally, Dr Freeman expressed his views by elaborating on factors that may allow us to predict tendencies in Chinese investments in the EU. Firstly, he highlighted that for China, government conditions such as capital controls and policies on investments function as a guiding line when it comes to attracting investment flows. This is a two-way street – both for attracting investors into China through the liberalization of the so called Negative List, and for Europe, which despite being one of the most open economies in the world with limited restrictions on investment inflow, is still perceived as a protectionist bastion by some Chinese firms.

Additionally, when it comes to investing in Europe, Chinese enterprises tend to look beyond the legally regulated economic environment, and also question how stable, risk-worthy, and growth-prone a region is for investment.

Next, he reaffirmed Mr Min's view that domestic conditions in China are preconditions for any possible outward expansion and exemplified this by commenting on China's past – when the domestic growth opportunities were sufficient and there was little incentive to go abroad, far fewer private companies were investing internationally.

Q&A

Questions raised during the Q&A session included: the competition problem that arises from the mismatch of Germany and China's budget on industrial research; Made in China 2025 plan and the scrutiny surrounding it; the level of control of state-owned enterprises; and the recently opened Shanghai Free Trade Zone.

Conclusion

To conclude, it is difficult to make definite observations on Beijing's stance towards the ISDS and its possible reforms due to the considerably low involvement in ISDS cases compared to its robust FDI outflow. The slowdown of the Chinese economy and the effort to open Chinese markets to FDI since 2012 tell us that the issue of reforms in international investment practice will only get more and more relevant to the global economy. Unresolved issues include Chinese efforts to minimise the foreign presence in key sectors and the strong grip of state-owned enterprises that are responsible for the majority of the FDI outflow. Possible remedies for such disbalance are well-negotiated BITs and the reform of the ISDS.

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