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Chinese Weaponized Investments and the Rise of Screening Mechanisms in Europe

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Key Points:

- Through the “Going Out” Strategy, “China 2025,” and the “Belt and Road Initiative,” China’s increased investments abroad have been used as a weapon to secure access to foreign technology and promote its leading role in the world economy.
- Partly as a reaction to China and its weaponized investments, a global increase in screening mechanisms has taken place in the name of protecting national security.
- The European Union has changed its strategy toward China, and it recently created a common screening mechanism.
- China’s global rise and its effects on changing the legal investments landscape.

The European Union’s first common screening mechanism, which entered into force in April 2018, reflects a new direction in the global legal

landscape of investments. Contrary to the general trend of the last part of the twentieth century - a legal landscape open and supportive to investments, mostly directed from the global north to the global south - the past few years have seen a global rise of screening mechanisms aimed at assessing and investigating various Foreign Direct Investments (FDI), and increasing public authorities’ power to authorize, condition, or prohibit foreign investments. The reversal of the liberal attitude that incentivized FDI, reduced barriers, and simplified processes has been justified by concerns for national security and sensitive industries. It can be seen also as a reaction to the emergence of new global actors that challenge power distribution, potentially redefining international norms. In particular, the new mechanisms are often perceived as reacting to China’s rise and its weaponized investments, through which companies becomes armies of Chinese foreign policy. By “weaponized investments,” I mean investments that are used

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for national security imperatives. In the case of China such investments aim at acquiring leading technology that in the future might be used to further develop the country's military capabilities and transforming the nation into a tech superpower. Contrarily to the current other major powers, China still lags behind in terms of technology and military capabilities and the central government has started a series of initiatives and strategies to coordinate the country's new tech ambitions.

With the "Going Out" strategy, "China 2025," and the "Belt and Road Initiative," China has expanded its investments worldwide. While its FDI have dramatically decreased over the past three years due to the global rise of screening mechanisms, as well as increased capital control and a tightening of liquidity in China, in 2016 its outward FDI had jumped to almost US\$200 billion (an increase of 40 percent from 2015), targeting mostly high-tech, services, and infrastructure assets, thus making China the world's second-largest source of outward FDI.² A similar pattern can be seen in Europe, where China's investments expanded to

almost EUR 37 billion in 2016 (an increase of 77 percent from 2015) – also targeting mostly high-tech, services and infrastructure assets³—but then declined in 2018 to EUR 17.3 billion for similar reasons to the general decline of Chinese FDI.⁴

EU economies are more attractive than ever to China due to its ongoing trade war with the US, especially now that the many technology-intensive firms operating in the EU Single Market with a high degree of integration constitute an alternative to the US market. The EU still encompasses some of the most advanced economies in terms of technology and international management know-how, and their brands are widely known and recognized as quality or luxury. Analysis of Chinese outward FDI has shown that the EU has become an increasingly important destination for strategic-asset-seeking Chinese FDI since the 2008 financial crisis, in order to close the gap with global competitors in terms of innovation and management know-how.⁵

The US has long been the most vocal critic of China and its weaponized investments.⁶ While the

² See data of FDI trend from International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD) and the Organization for Economic Co-operation and Development (OECD), AEI China Global Investment Tracker, <https://www.aei.org/china-global-investment-tracker/?ncid=txtlnkusaolp00000618>. See also Thilo Hanemann and Mikko Huotari, *Chinese Investment in Europe in 2016*, MERICS, (2017) available at http://rhg.com/wp-content/uploads/2017/01/RHG_Merics_COFDI_EU_2016.pdf.

³ Thilo Hanemann, Mikko Huotari & Agatha Kratz, *Chinese FDI In Europe: 2018 Trends And Impact Of New Screening Policies*, MERICS, (2019) available at https://www.merics.org/sites/default/files/2019-03/190311_MERICS-Rhodium%20Group_COFDI-Update_2019.pdf.

⁴ In 2018 the main recipients continued to be the "Big Three:" the UK (EUR 4.2 billion), Germany (EUR 2.1 billion), and France (EUR 1.6 billion). *Ibid*.

⁵ Jean-Christophe Defraigne, *Chinese outward direct investments in Europe and the control of the global value chain*, ASIA EUROPE JOURNAL (Apr. 2017) 1-16.

⁶ See US NATIONAL SECURITY STRATEGY (2017) <https://www.whitehouse.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf>; US NATIONAL DEFENSE STRATEGY (2018) <https://www.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf>; John Mearsheimer, *China's Unpeaceful Rise*, CURRENT HISTORY 105 (April 2006), 160–2; JOSHUA KURLANTZICK, CHARM OFFENSIVE: HOW CHINA'S SOFT POWER IS TRANSFORMING THE WORLD (2007); White House Office of Trade and Manufacturing Policy, *How China's Economic Aggression Threatens the Technologies and Intellectual Property of the United States and the World*, (June 2018), <https://www.whitehouse.gov/wp->

EU has enjoyed an enduring relationship and comprehensive strategic partnership with China, being its biggest trading partner, lately the EU has become more outspoken and critical toward this emerging global power.⁷ The US was the first to discuss China's weaponized investments, and in 2018 the inter-agency Committee on Foreign Investment in the United States (CFIUS) was reformed and modernized through the Foreign Investment Risk Review Modernization Act (FIRRMA). CFIUS jurisdiction was expanded to address growing national security concerns over foreign investments in new sectors such as technology and critical infrastructure.⁸ As stated by a 2018 White House Office of Trade and Manufacturing Policy report, granting Chinese companies access to high-tech could favor the broader China 2025 strategy and open the US and the world to China's economic aggression aimed at gaining access to technologies and intellectual property.⁹

EU member states have generally been less aware of Chinese strategic-asset-seeking FDI than the US or Japan.¹⁰ But the recent creation of screening mechanisms in the EU and at the individual member states level reflects a broader

transformation in the EU's approach to China.¹¹ Notably, the recent EU Commission's Joint Statement took a position similar to that of the US—not only defining China as a “systemic rival,” but further stating that it is promoting alternative models of global governance.¹² EU strategy has become more “realistic.” China is now seen as a strategic competitor aiming to become a leader in technology and to challenge the EU and China 2025 is seen as a way to leapfrog Europe and other countries through its technological advantages.¹³ The EU's new tone and strategy have been accompanied by the creation of the first EU-level screening framework aimed at defending Europe's “technological sovereignty” and closing the legal gap in investment oversight in the European common market. This could transform the open environment for investments that has characterized the EU, particularly impacting Chinese investors.

The sense of China's threat is not unfounded, and the EU oversight gap is real, especially in light of China 2025 and the EU's lack of a comprehensive policy or tool to monitor Chinese technology acquisitions. Both China 2025 and the BRI aim at acquiring technology, and the Chinese

content/uploads/2018/06/FINAL-China-Technology-Report-6.18.18-PDF.pdf.

⁷ As for trade, in 2018, China was the second largest partner for EU exports of goods with a total EU export of goods of EUR 209 billion and the largest partner for EU imports of goods, where EU imports Chinese goods to a value of almost EUR 400 billion. *Data available at* https://ec.europa.eu/eurostat/statistics-explained/index.php/China-EU_-_international_trade_in_goods_statistics.

⁸ See White House, *supra* note 5. For the new relevance of infrastructure, see Cornyn, Baldwin, Crapo, Brown Secure Amendment to Protect Rail and Bus Manufacturing from China Threat in Senate Defense Bill, (June 20, 2019), [https://www.brown.senate.gov/newsroom/press/release/cornyn-baldwin-crapo-brown-secure-amendment-to-protect-](https://www.brown.senate.gov/newsroom/press/release/cornyn-baldwin-crapo-brown-secure-amendment-to-protect-rail-and-bus-manufacturing-from-china-threat-in-senate-defense-bill)

[rail-and-bus-manufacturing-from-china-threat-in-senate-defense-bill](https://www.brown.senate.gov/newsroom/press/release/cornyn-baldwin-crapo-brown-secure-amendment-to-protect-rail-and-bus-manufacturing-from-china-threat-in-senate-defense-bill).

⁹ White House, *Supra* note 6.

¹⁰ DeFraigne, *supra* note 5.

¹¹ BRUNO MAÇÃES, BELT AND ROAD: A CHINESE WORLD ORDER (2018).

¹² European Commission and HR/VP contribution to the European Council, *EU-China – A Strategic Outlook*, (2019) <https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf>.

¹³ Guy Chazan, *Altmaier urges EU to protect technology from Chinese rivals*, FINANCIAL TIMES (February 17, 2019), available at <https://www.ft.com/content/6757c9a9-3048-11e9-8744-e7016697f225>.

government now openly commits to “direct enterprises to integrate into local culture ... [and] support enterprises to perform mergers, equity investment and venture capital investment overseas.”¹⁴ The China 2025 document shows that preferred investments are in high-tech industries like artificial intelligence, robotics, and space travel, because these will help fill China’s technology gap.¹⁵ The authorities have been pursuing an active industrial policy to enable Chinese national champions to move up the value chain and challenge the European incumbents. They have fostered strategic-assets-seeking outward direct investments by Chinese firms in the EU, aimed at taking over crisis-weakened European enterprises to capture technology and management know-how.¹⁶ Moreover, Chinese weaponized investments occur in an unbalanced context, as it is very difficult for the EU to access China’s market and invest in it. Although China’s rise has been largely due to foreign FDI and technology transfer over the past four decades, these have been extremely regulated and restricted; it is far from a free and open market. Only in March 2019, with the passing of the New Foreign Direct Investments Law, has China moved to abolish negative lists.

For these reasons, the EU and some member states have created or modernized their screening mechanisms. Germany brought in a sector-specific screening mechanism in 2004 and tightened it and expanded its scope of jurisdiction beyond specific industries in 2017 and 2018. It now

includes several critical infrastructures, and the maximum voting rights a foreign entity can acquire has been lowered from 25 to 10 percent in cross-sector foreign investment control. This move was partly in response to the State Grid Corporation of China’s attempt to acquire a 20 percent stake in German electricity transmission system operator 50Hertz in 2018. Despite security considerations, the German Federal Ministry for Economic Affairs and Energy was unable to screen the investments because the stake was under 25 percent. In the end, the government instructed state-owned development bank KfW to make the acquisition.

France tightened its screening mechanism regime in 2014 by amending the French Monetary and Financial Code to include six new sectors, among them, private security services, security information, and information technology systems. Now, non-EU investors in certain sectors must obtain authorization before starting any operation. Italy created its first screening mechanism in 2012 (Law Decree, no. 21/2012), updated in 2017 (Law Decree no. 148/2017) to grant special, or “golden,” powers to the government to review foreign acquisition of stakes in Italian public and private companies whose activities have “strategic relevance in the defense and national security sector” or “assets with strategic relevance in the energy, transport and communication and high-tech sectors.” Since 2016, the number of screened operations has increased. Fifteen other EU countries also have

¹⁴ Guowuyuan guanyu yinfa “zhongguo zhizao 2025” de tongzhi (国务院关于印发《中国制造2025》的通知) Notice of the State Council on Printing and Distributing “Made in China 2025”] (May 2015), available at http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm

¹⁵ See Cory Bennett and Bryan Bender, *How China acquires ‘the crown jewels’ of US technology*, POLITICO, (May 25, 2018) <https://www.politico.eu/article/china-investment-uber-apple-us-tech-how-china-acquires-the-crown-jewels/>.

¹⁶ Defraigne. *Supra* note 5.

screening mechanisms, and in the past two years Hungary, Latvia, Lithuania, Spain, and the UK have revised and tightened theirs, too. Others are considering creating or further modernizing their own systems.

Until this year, however, some member states still lacked such mechanisms, and coordination at the European level among member states was lacking. It was the European Commission that, heeding calls from Italy, Germany, and France for veto rights in Chinese high-tech takeovers, launched a proposal for a European framework in September 2017. In 2018, the EU Council and Parliament presented their own positions at negotiations for a tripartite agreement on a draft regulation, which was approved by both Parliament and Council in 2019. EU regulation no. 2019/452 establishes a framework for cooperation and permanent coordination among member states for screening FDI in the EU on grounds of security or public order.¹⁷ It allows the Commission to issue opinions when an investment poses a threat to the security or public order of more than one member state or could undermine a project or program of interest for the whole EU, such as Horizon 2020 or Galileo. In determining if FDI affects security or public order and should thus be screened, member states and the Commission should look at its potential effects on critical infrastructures, critical technologies, supply of critical input, access to sensitive information, and the freedom and pluralism of the media, but also whether investment is directly or indirectly government-controlled (Art. 4).¹⁸ While the new regulation sets certain requirements for member states wishing to

maintain or adopt a national-level screening mechanism, they each retain the last word on whether a specific investment operation is allowed in their territory, as each state retains sole responsibility for its national security (Article 4(2) TEU), and accordingly for its essential security interests (Article 346 TFEU).

The new European Commission's "EU-China – A Strategic Outlook" seems to tie the new mechanism to China. It justifies establishing a framework for screening FDI, which entered into force in April 2019 and will fully apply from November 2019, for "foreign investments in strategic sectors, acquisition of critical assets, technologies and infrastructures in the EU [particularly 5G], involvement in EU standard setting and supply of critical equipment that can pose risks to the EU's security."¹² According to a recent report, at least 82 percent of Chinese investments will be affected by the new screening mechanism, as many areas that should go under special scrutiny, especially technology and innovation sectors and investments directly or indirectly led by state-controlled entities, are preferred sectors for Chinese investors in Europe – although sometimes the divide between private and public is difficult to determine in Chinese companies and corporate structures.

We are at a critical historical moment that is redefining not only the international investment regime but the fundamental principles underpinning it. While the EU and other countries, especially developing ones, must remain vigilant about China and its investments,

¹⁷ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union,

OFFICIAL JOURNAL OF THE EUROPEAN UNION, (2019), <https://eur-lex.europa.eu/eli/reg/2019/452/oj>.

¹⁸ *Id.* Art. 4.

and it is completely legitimate to scrutinize third-country investments for national security reasons, such controls should not be used as a pretext for protectionism and discrimination against non-EU investment. The question is how to balance trade protectionism, threats to national security, and necessary regulation with open markets and free movement of capital, as over-regulation can hamper global growth and the exchange of capital and talent. No matter what trajectory the future global order takes, China will increasingly co-shape it. The fact that such a nation is pursuing an active industrial policy is unsurprising, and the EU

or U.S. cannot prevent the upgrading of China's economy. There is a real need to create new common rules of public international law that can contribute to promoting coordination among actors of the global North and South, and also promote the transparency and predictability of the international economic and legal regime.

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