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China as an Investment Power in Europe

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Executive Summary

- Chinese Foreign Direct Investment (FDI) in Europe has overtaken European FDI in China, in part due to the Chinese 'Going out' strategy.
- In view of this trend, the broader public and foreign policy circles in big EU member states, such as Germany and the UK, fear a loss of their countries' competitive advantage and technological know-how.
- High-profile investment cases have led European countries to introduce safeguards for security-related investments and critical infrastructures.
- Putting in place institutions such as the EU-China Comprehensive Agreement on Investment and safeguards for Chinese-funded projects, but also enhancing their legitimacy with the European public will be crucial.
- European policy-makers will have to increase their understanding of the variety of Chinese investors, be they state-owned enterprises or private companies, and at the same time avoid demonization of Chinese FDI.

Discussions about Chinese investments in Europe in recent years have tended to stir public controversy and outright suspicions . As Chinese investments have risen strongly since the start of the financial crisis, some of the reactions by European politicians and media hint at a broader change in power relations between the two actors and an increasing threat perception in Europe. One of the reasons for this is the fact that Europeans see China competing at the same or a higher level. Good examples are large infrastructure projects, which, while very hard to implement in Europe, are quite common in China's growing cities. This policy brief looks in more detail at what these investments tell us about Chinese FDI policy as well as how they are received in Europe. It examines in particular the energy sector, which has attracted increasing public attention, is linked to vital national interests and represents one of the main destinations for Chinese investors. The example of a Chinese state-owned company's investment in the construction of the British nuclear point Hinkley Point C illustrates how business decisions are increasingly related to public perception and foreign policy in Europe. It concludes by highlighting how the EU could play an important role in creating predictable and legitimate rules for Chinese FDI through the conclusion of the EU-China Comprehensive Agreement on Investment.

Converging policy challenges in Europe and China

Chinese FDI in Europe has been increasing since 2011. In the energy sector, most of the funding has gone into technology investments into fossil fuel, renewable energy and utility assets. Chinese FDI has evolved in three phases (Jia 2015). From 2001-2008, that is pre-crisis, China's admission to the WTO and deregulation saw only a small portion of FDI going to Europe, while the large majority went to Asia. During the height of the financial crisis (2009-2012), there was a policy encouraging investment in Europe, which was met by European countries actually competing for Chinese FDI. Since 2012, a further strategic push on the Chinese government side as well as a more sophisticated strategy on the part of Chinese companies can be observed. The EU initiated the negotiations for an EU-China investment agreement in order to achieve reciprocal treatment in the Chinese market, for example concerning intellectual property rights.

Since the crisis, Chinese companies have particularly been buying infrastructure assets for privatisation in countries such as Greece and Portugal. Other examples include French nuclear company Areva's deepening ties with China. There are plans by the China National Nuclear Corporation (CNNC) and China General Nuclear Power Group (CGN), both state-owned companies, to obtain considerable shares in the French company. In line with that trend, CGN has also bought a 33.5 per cent stake in the British Hinkley Nuclear Power Plant project.

There are several reasons for the increased FDI in energy from the Chinese perspective. First, China is in a process of reform of its economic system, which includes opening its capital markets and facilitating investments at home and abroad. The existing system of economic growth has been driven by investment in domestic infrastructure, creating overcapacities in some sectors and being increasingly difficult to sustain. Second, initiatives like 'One Belt, One Road' combine the new Chinese role as a global investor with energy security interests. The Chinese government is pushing towards a more competitive energy market domestically, especially in the area of renewable energy and to some extent nuclear power. It is also encouraging companies to invest abroad to open new markets and secure lines of energy supply. The Chinese solar industry is world-leading, which is why including considerable environmental requirements among the criteria of the Asian Infrastructure Investment Bank (AIIB) is also aimed at creating demand in third countries. Finally, the United States (US), the United Kingdom (UK) and other European countries are still popular targets of FDI, since favourable investment conditions, big markets, and reliable and transparent legal systems remain attractive. Chinese investment is especially directed to knowledge-intensive economies (such as UK, Germany, France, Sweden) and large countries.

As Chinese FDI has only become available in the past several years, the EU is working towards regulating investments through the EU-China Comprehensive Agreement on Investment, which is currently under negotiation. This agreement will have several clauses protecting standards, intellectual property, etc. There is no ban or embargo limiting Chinese investments in sensitive infrastructures in Europe. However, in the absence of a European regulatory framework, member states differ greatly in the restrictions they impose on Chinese investment. A common worry concerns the different roles of state-owned and private investors coming to Europe. It is a paradox that European publics are highly skeptical of state-backed FDI for reasons of protecting intellectual property and maintaining security, while Chinese experts rate the risk of 'predatory' or 'careless' investing much higher from private companies.

To show how these dynamics play out in practice, the following section will look more closely at one of the evolving cases of Chinese FDI: CGN's stake in the first new nuclear power plant in a generation in the United Kingdom.

CGN's share in UK's Hinkley Point C nuclear power plant

In 2006, the UK government decided that a future energy mix which would reduce carbon emissions needed to feature nuclear power. After choosing the site of Hinkley Point C for the construction of a new nuclear power plant and initial price negotiations in October 2015, the main investor Eléctricité de France (EDF) from France got China General Nuclear Power Group (CGN) on board to invest around 33.5 per cent in the £18 billion project. While there was already much debate about the viability of the new nuclear plant prior to the announcement of the Chinese investment, the Chinese involvement brought national security considerations to the fore. In a highly controversial move, newly appointed Prime Minister May delayed the government's approval of the project in July 2016. A month later she gave her final go-ahead, however, only with a caveat of further government approval should the share of CGN in the investment increase.

Since October 2015, there are several key actors involved in the deal. Three governments, the UK, France and China; two companies (EDF Energy and CGN); as well as the EU as investment regulator. The EU institutions were involved earlier when approving the project as such as well as the British government's guarantees for electricity prices, but the Union did not pronounce itself on the fact that a Chinese company was joining the investors. French government representatives welcomed the final approval, since the project as a whole is considered crucial for promoting French Evolutionized Pressure Reactor (EPR) technology. The focus remains firmly on the economic progress of the nuclear industry and technology development, and May's decision validated the French industrial strategy to invest into nuclear power.

The British and the Chinese governments took key roles in the public debate. The British government considers the project important for several reasons. If safety concerns and the question of storage of nuclear waste are taken out of the equation, the project is promising on several accounts: it is predicted to create jobs (around 25,000 in construction and operation), demonstrate the feasibility of big infrastructure projects in Europe and the British government hopes to strengthen the UK's leadership position on nuclear technology though its support. It would put the UK on a clear course toward achieving the Paris climate mitigation commitments. Hence, especially engineers are almost unanimously positive (Levey & Smith 2016). Worries about changing energy prices, significant cost increases for the British taxpayer and a delayed timeline for construction are part of the ongoing discussion about the project's economic viability. However, inviting Chinese external investment rather than raising the missing 33 per cent domestically, is beneficial for balancing the UK's big current account deficit (7.2 per cent of GDP in the last quarter of 2015) (Davies 2016). Finally, the investment was agreed during the visit by Chinese President Xi Jinping in London in October 2015. Its conclusion was hailed as part of the British-Chinese 'Golden Year' and 'Golden Age'.

The Chinese government is pursuing several strategic objectives by facilitating CGN's investment. One is about the UK-China relationship, which it is keen to develop, in particular economically. Second, exporting Chinese nuclear technology is part of the overall 'Go Global' strategy. While CGN would only financially invest in Hinkley Point C, part of the deal is also for CGN to later be allowed to construct a power plant with Chinese technology in another British site, Bradwell. It would mean exporting the Hualong One reactor type (referred to as HPR1000 on the European market) to Europe for the first time. The Bradwell plant signifies a shift in the bilateral relationship between the UK and China: as China was developing its own nuclear industry, it first used European and US technology and safety standards. Now it is not only using Chinese technology but even exporting it back to Europe, which shows that China is able to compete at the same level as Europe, if not reversing the relationship in specific technologies.

Public reactions to China's 'Investment Power'

The British public was eyeing the continuous debates about the project and seems to feel increasingly pessimistic. In a poll by Populus in September 2015, only 25 per cent of British citizens supported the project, while 44 per cent were opposed.

The public debates on the Chinese investment display the underlying expectations and fears that come with a seemingly 'objective' business decision. Initially, Chinese investment in the project was carefully prepared under Prime Minister Cameron as one of the big successes during bilateral meetings in London in October 2015. Chancellor Osborne had visited Beijing a month before and secured the deal. In the same month, media narrative and pre-occupation with national security considerations started slowly coming to the fore. A major turning point was the change in government following the British EU referendum in June 2016. Once Cameron gone – Hinkley Point C having been one of his brainchildren – new Prime Minister May questioned the investment. While there was speculation on what elements her re-opening of the case would focus on, the approval in September 2016 demonstrated that it was the Chinese investment. Given the introduction of a new legal framework, May then gave the green light.

This legal framework, which does apply to future Hinkley Point decisions, but would also include Bradwell, will provide the government with a veto right for foreign direct investments in critical infrastructures. This provision responds to British concerns, but it could also simply be symbolic of May's more careful attitude when compared to her predecessor. Judging from the changes under the new agreement, the main concerns truly were about ownership and security since part-owner CGN is a Chinese state-owned company. May met Chinese President Xi Jinping also on the sidelines of the G20 summit in early September, reaffirming their commitment to continue the Chinese-British 'Golden Age'. With the new changes to the deal, May could appease concerns about Chinese partial ownership of Hinkley Point C and the prospect of a Chinese nuclear construction at the Bradwell site in the coming years. At the same time, an effort was made to be as diplomatic as possible by introducing a general national security test rather than focusing only on Chinese investment.

Thus, initially an energy project between France and the UK, the Chinese investment has turned it into a matter of foreign policy concerns in two regards: it has exposed the fear of possible interference in security infrastructure and shown the inability by the British side to refuse the Chinese investment at this point, due to broader strategic imperatives to reassure the bilateral relationship between the UK and China. As a journalist of *The Telegraph* criticised, 'if the chief reason for continuing the project is to preserve good relations with France and China, the whole story is a textbook example of why it is hazardous to strike commercial deals with foreign state-owned companies'.

The interpretation of the case and the development in China varies. For CGN the business angle is the most important one. Senior Vice-President of CGN, Zheng Dongshan, explains his company's motivation for the project: 'We have been working with EDF for three decades and we would like to bring the experience from China to the UK'. An observer also noted a core motivation to be the acquisition of technology. As a researcher from the Chinese Academy of Social Sciences expressed in an interview, 'In a way it is a pilot to show we can invest like that and it could possibly be a role model for other investments'.

However, from a government perspective the political gain outweighs such uncertainties. This became particularly clear during the delayed approval by May. Emphasizing that this project has a geopolitical and diplomatic angle, the Chinese ambassador to the UK said it was about 'mutual trust' between the two countries and made his discontent with the repeated delay explicit in a *Financial Times* op-ed on August 8 (Liu 2016). In terms of the political aspects of the project, the Chinese mainstream view became mostly unified. Delaying or even cancelling the project was considered not only unwise but also extremely risky for the British government. Over the years, China has seen the UK as a doorstep to the European market, and invested tremendous amounts of money into the UK. But the recent Brexit movement and result coming from it adds uncertainties to that relationship. Therefore China will watch how May deals with this project very cautiously since it may give an indication as to whether the UK will still be playing this liaison role between China and Europe.

A new type of FDI dynamics

While the Hinkley Point C decision was particularly high profile and the final outcome has not yet been fully settled, the debate about Chinese FDI exposes new power dynamics between the EU and China, perceived as such in particular in the EU. It is representative of similar cases in Europe, such as State Grid's bid for a stake in the Belgian gas and electricity network of distributors Eandis and the takeover of German robotics manufacturer KUKA by Chinese company Midea. Public debates in these cases are highly politicized and limit the room for manoeuvre for European companies and policy-makers. Looking at the example of the energy sector, two trends become evident: first, China and the EU increasingly pursue similar policy objectives in terms of developing energy technologies and securing global markets. This level playing field signals the two as competitors. European identity is furthermore put into question as Chinese investment behaviour is juxtaposed to a perceived weakness in implementing large-scale infrastructure projects in Europe after the financial crisis. Second, investment decisions – often initiated by businesses but allowed by governments – are perceived as assertions of power similar to that of trading or military strength, evoking feelings of fear.

For the EU, this has several implications. The EU should work hard to conclude a bilateral investment treaty, replacing 27 such treaties between EU member states and China. By applying uniform rules and addressing valid concerns about Chinese investment conditions relating to security and social, economic and environmental safeguards, investments in Europe would become more predictable (Chinese companies also suffer when FDI cases get politicized) as well as legitimate. Ultimately, the building of knowledge on the different types of investors will also help to build European regulators' capacity to appropriately deal with the Chinese investment European member states are actively trying to attract. This can also involve the need for European companies to make clear assessments on the investor's identity before engaging in any deal. The development of long-term relationships between Chinese and European companies would best ensure such a good knowledge of the Chinese interlocutors.

Further Reading

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