



## Systemic rivalry and balancing interests: Chinese investment meets EU law on the Belt and Road

Steven Blockmans and Weinian Hu

### Abstract

For years, the EU has refrained from criticising China's attempts to shape globalisation according to its own interests. Member states have allowed the Belt and Road Initiative (BRI) to tip the balance of power towards the companies that China owns or subsidises.

Alarmed by recent Chinese takeovers in strategic industries, the EU has flagged up its intention to toughen rules on foreign investment flows into Europe. The brand-new EU Strategic Outlook on China adopts a multifaceted approach and defines the 'Middle Kingdom' simultaneously as a cooperation and negotiation partner with whom the Union needs to find a balance of interests, an "economic competitor" in pursuit of technological leadership, and a "systemic rival" promoting alternative models of governance.

This paper takes stock of BRI investments in Europe and of member states' concerns about economic and national security. It then examines the EU-wide legal bulwarks and regulatory responses that are intended to hedge against unfair practices. It concludes that, while a more realistic and assertive European approach toward Chinese market behaviour is welcome, the EU should take China up on its pledge to embolden the BRI with 'soft connectivity', i.e. a legal infrastructure, rather than risk mutual harm by adopting too protectionist a stance. This should benefit not just the EU and China but also the other '16+1' countries along the central corridor of the BRI, which passes through the Caucasus, the Balkans and Eastern Europe – all in the spirit of the EU's 2018 connectivity strategy with Asia.

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The gentleman aims at harmony, not uniformity.

*Confucius*

## 1. Introduction

When the European Commission approved the Hungarian government's €45 million investment aid to the Chinese state-owned enterprise (SOE) BorsodChem<sup>1</sup> in September 2018, the legal obstacles that the Belt and Road Initiative (BRI) had encountered in the single market of the EU were removed to serve the "community interest". While the Commission concluded that the investment in BorsodChem was not economically sound,<sup>2</sup> it found that the aid would not unduly distort competition in the single market but rather help job creation, regional development and the attainment of environmental objectives.

The BorsodChem case exemplifies a growing dissonance in perceptions about the BRI as a shared opportunity between the EU and China. For China, the BorsodChem aniline project embodies the motto of the BRI, i.e. 'win-win cooperation' that promotes common development and prosperity<sup>3</sup> between China and a BRI hosting country. Seen in this light, BorsodChem is a concrete deliverable,<sup>4</sup> a milestone in implementing the BRI and the China-CEEC (Central and Eastern European Countries) cooperation, also known as the '16+1 Initiative Cooperation'.<sup>5</sup> As such, the BRI appears more of a grand geopolitical strategy than an economic blueprint.<sup>6</sup>

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<sup>1</sup> In 2011, China's Wanhua Industrial Group acquired full control of BorsodChem in a €1.2 billion deal. See "Wanhua takes full control of BorsodChem", *Financial Times*, 1 February 2011.

<sup>2</sup> This is because, without the public funding, the project would not have been carried out in Hungary or any other member states. It would have been cheaper to continue importing aniline from the group's parent company in China. Also, the aid is limited to the minimum necessary to make the project profitable for the company's decision to invest. The €45 million state aid is Hungary's additional financial support to the €142 million investment in a new facility for producing aniline at BorsodChem's existing plant, which currently imports aniline from its parent company, the Wanhua Industrial Group, headquartered in Shandong Province, China. See European Commission, "State Aid: Commission approves Hungary's €45 million investment aid to chemical company BorsodChem Zrt to be in line with EU State aid rules", Press release, Brussels, 28 September 2018.

<sup>3</sup> See NRDC, "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road", RPC, 28 March 2018 ([http://en.ndrc.gov.cn/newsrelease/201503/t20150330\\_669367.html](http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html)).

<sup>4</sup> In May 2017, as the first deliverable of the Sino-Hungary €1 billion loan facility cooperation, the China Development Bank provided an €79 million on-lending loan to fund the construction of a chlorine production line at BorsodChem. See China Development Bank Annual Report 2017, at 49.

<sup>5</sup> See China's Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries, published at the "16+1" Summit, Warsaw, 2012.

<sup>6</sup> A White House spokesman has recently criticised the BRI as "made in China, for China". See G. Rachman, "The US, China and the return of a two-bloc world", *Financial Times*, 11 March 2019. The 2018 US National Defense Strategy builds on the 2017 National Security Strategy's qualification of China as a 'revisionist power' and defines China as "a strategic competitor using predatory economics to intimidate its neighbors while militarizing features in the South China Sea". See <https://dod.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf>.

After decades of foreign policy characterised by Deng Xiaoping as “lying low” and “biding time” - intended to focus on domestic development for a harmonious society, a more assertive China has emerged, staging its leadership desire in regional and international affairs. Launched in a speech by Xi Jinping in 2013, the Belt and Road Initiative<sup>7</sup> is the most ambitious project since the 2001 creation of the Shanghai Cooperation Organisation. The BRI has been developed ‘on the fly’ but nevertheless attracted the active participation of nearly half the UN membership. Lured by the power and the purse of the world’s emerging hegemon, governments around the world (from Indonesia to the UK and from Tanzania to Brazil) have signed up to multimillion dollar loans provided by Chinese financial institutions and the Asian International Infrastructure Bank (AIIB).<sup>8</sup> These loans have been used to invest mainly in ‘hard connectivity’, i.e. transport, energy and infrastructure projects, often carried out by Chinese SOEs. Shrouded in secrecy and marred by allegations of corruption, some (successor) governments at the receiving end have since been forced to “cough up” ports, bridges and roads when they defaulted on the terms of their contracts.<sup>9</sup>

***Weakened by years of economic crisis and alarmed at reports about the “debt traps” that China has been laying along the Belt and Road, the EU has flagged its intention to get tougher on FDI inflows into Europe.***

Given the scale, political drive and financial means committed by China to the BRI, much of the cash-strapped world was initially star-struck, but now increasingly sees it a challenge. In Europe, China has long had a reputation for insufficient protection of intellectual property rights and poor oversight of its export control rules regarding sensitive technologies. In several European capitals, frustrations about how China has pushed its domestic growth agenda are compounded by worries about Beijing’s ‘imperialist’ tendencies; worries that China is throwing its economic weight and political clout around along the new

Silk Road.<sup>10</sup> Weakened by years of economic crisis and alarmed at reports about the “debt traps” that China has been laying along the Belt and Road, the EU has flagged its intention to get tougher on FDI inflows into Europe.<sup>11</sup> Other concerns about industrial espionage, national

<sup>7</sup> Originally called One Belt One Road (OBOR), then Belt and Road (Initiative). On 28 March 2015, China published the *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road* to unveil the principles, framework, cooperation priorities and mechanisms in the BRI. On 20 June 2017, the State Council further published the *Vision for Maritime Cooperation under the Belt and Road Initiative* in order to synchronise development plans and promote joint actions among countries along the 21st Century Maritime Silk Road.

<sup>8</sup> See the *Economic Development along the Belt and Road 2017*, by China Development Bank (CDB), United Nations Development Programme (UNDP) and Peking University (PKU).

<sup>9</sup> See M. Abi-Habib, “How China Got Sri Lanka to Cough Up a Port”, *New York Times*, 25 June 2018. In Europe too, questions have been raised about the economic logic of China’s BRI investment in infrastructure. A state-of-the-art highway from the Montenegrin port city of Bar to the Serbian border is a case in point. See N. Barkin and A. Vasovic, “Chinese ‘highway to nowhere’ haunts Montenegro”, *Reuters*, 16 July 2018.

<sup>10</sup> See J. Anderlini, “China is at risk of becoming a colonial power”, *Financial Times*, 19 September 2018.

<sup>11</sup> See, e.g. Commission Decision of 29 November 2017 setting up the group of experts on the screening of foreign direct investments into the European Union, C(2017) 7866 final. In his speech before the European Parliament on 17 April 2018, French President Macron gave new political impetus to plans to develop an EU-wide FDI screening mechanism. See <https://www.elysee.fr/emmanuel-macron/2018/04/17/speech-by-emmanuel-macron-president-of-the-republic-at-european-parliament.en>.

security and public order have led several EU member states to reject Chinese investments or acquisitions in strategic sectors such as telecoms (cf. the role of Huawei in developing 5G wireless networks – Box 7),<sup>12</sup> nuclear energy (cf. the modernisation of two nuclear reactors in the Czech Republic – Box 4), robotics (cf. the successful takeover of German firm Kuka – Box 8) and semi-conductors with dual-use potential (cf. the failed attempt to buy German chip maker Aixtron – Box 9).

Apart from the challenges posed to their slowly recovering economies, the majority of European governments are aware of the risk that China is upsetting the Western-led governance mechanisms by using the BRI as an instrument to export its own development model.<sup>13</sup> In so doing it is eroding the principles of international trade and investment such as national treatment, reciprocity, transparency, environment-friendly rules and social sustainability. “On which standards are we operating?” has become an apparent question in European policy circles.

Rather than debunking the Belt and Road Initiative outright, the European Commission and High Representative recently proposed a policy shift by stating the EU’s terms of engagement with China in a new ‘Strategic Outlook’, which was welcomed by the Foreign Affairs Council on 18 March 2019.<sup>14</sup> Stating that “there is a growing appreciation in Europe that the balance of challenges and opportunities presented by China has shifted” and that “China can no longer be regarded as a developing country”, the EU strategy adopts a multifaceted approach and defines the Middle Kingdom simultaneously, in different policy areas, as:

“a cooperation partner with whom the EU has closely aligned objectives, a negotiation partner with whom the EU needs to find a balance of interests, an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance.”

The EU’s ten-point action plan aims to fill the current gaps in EU law on competition and state aid, investment and procurement. In a prelude to the plans, China’s Ambassador to the EU had

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<sup>12</sup> “Huawei: ‘Deep concerns’ over firm’s role in UK 5G upgrade”, BBC World News, 27 December 2018. See also K. Dębiec, J. Groszkowski, M. Bogusz and J. Jakóbski, “The Czech-Chinese dispute over Huawei and ZTE”, OSW Analyses, 17 January 2019.

<sup>13</sup> Following Xi Jinping’s speech of 17 January 2017 at the Davos World Economic Forum, the Ministry of Foreign Affairs summarised the main characteristics of China’s new economic diplomacy: guiding the world economy, championing global development, improving the model of economic governance, supporting national development strategies and sharing China’s development philosophy. See ‘China’s Economic Diplomacy Entered the New Era’, published in April 2017.

<sup>14</sup> Joint Communication, “EU-China – A strategic outlook”, JOIN(2019) 5 final, Strasbourg, 12 March 2019. The document “refines” the EU’s approach to China, as laid down in the 2016 EU Strategy on China, to be “more realistic, assertive and multi-faceted”. See the Foreign Affairs Conclusions of 18 March 2019. The EU Strategy on China was adopted by the Council on 18 July 2016, doc. 11252/16.

warned EU leaders not to draw “an Iron Curtain” which would “upset global economic and scientific innovation”.<sup>15</sup>

This CEPS Policy Insight takes stock of BRI investments in Europe and of member states’ concerns about economic and national security (section 2). An analysis of the EU-wide legal bulwarks and regulatory responses to address those concerns (section 3) will then allow us to collect ideas on how to increase transparency and convergence between not just the EU and China, but also the other ‘16+1’ countries along the central corridor of the BRI, which passes through the Caucasus, the Balkans and Eastern Europe (section 4), all in the spirit of the EU’s connectivity strategy with Asia.<sup>16</sup> It concludes that, while a more realistic and assertive EU approach toward Chinese market behaviour is welcome, the EU should take China up on its pledge to embolden the BRI with ‘soft connectivity’, i.e. a legal infrastructure, to truly achieve win-win cooperation,<sup>17</sup> rather than risk mutual harm by adopting too protectionist a stance.

## 2. Transition of China’s growth model and impact on Europe

Since 2013, there has been a surge of Chinese investment in the EU. Overall it accounts for one-quarter of EU FDI in China. After China’s August 2017 State Council published guidelines to curb “irrational” Chinese outbound FDI in sectors such as real estate, hotels, entertainment, sports clubs and outdated industries, Chinese FDI in the EU has decreased, following an international trend.<sup>18</sup> This decrease may also be the consequence of the investment-screening regimes that individual EU member states have been modernising. Chinese FDI in the EU fell to €29.1 billion in 2017, and further dropped to €17.3 billion in 2018 (Figure 1). Nonetheless, compared to 2016 figures, Chinese FDI in the EU in 2017 remained high in the sectors of transport, utilities and infrastructure, where investment doubled and jumped from €7.1 to €15.3 billion, but then suffered a decline in 2018; while the biggest increases were recorded in financial services, health and biotech, consumer products and services, and automotive (Figure 2).<sup>19</sup>

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<sup>15</sup> Z. Ming, “Digital ‘Iron Curtain’ makes no sense in 5G era”, *EU Observer*, 26 February 2019.

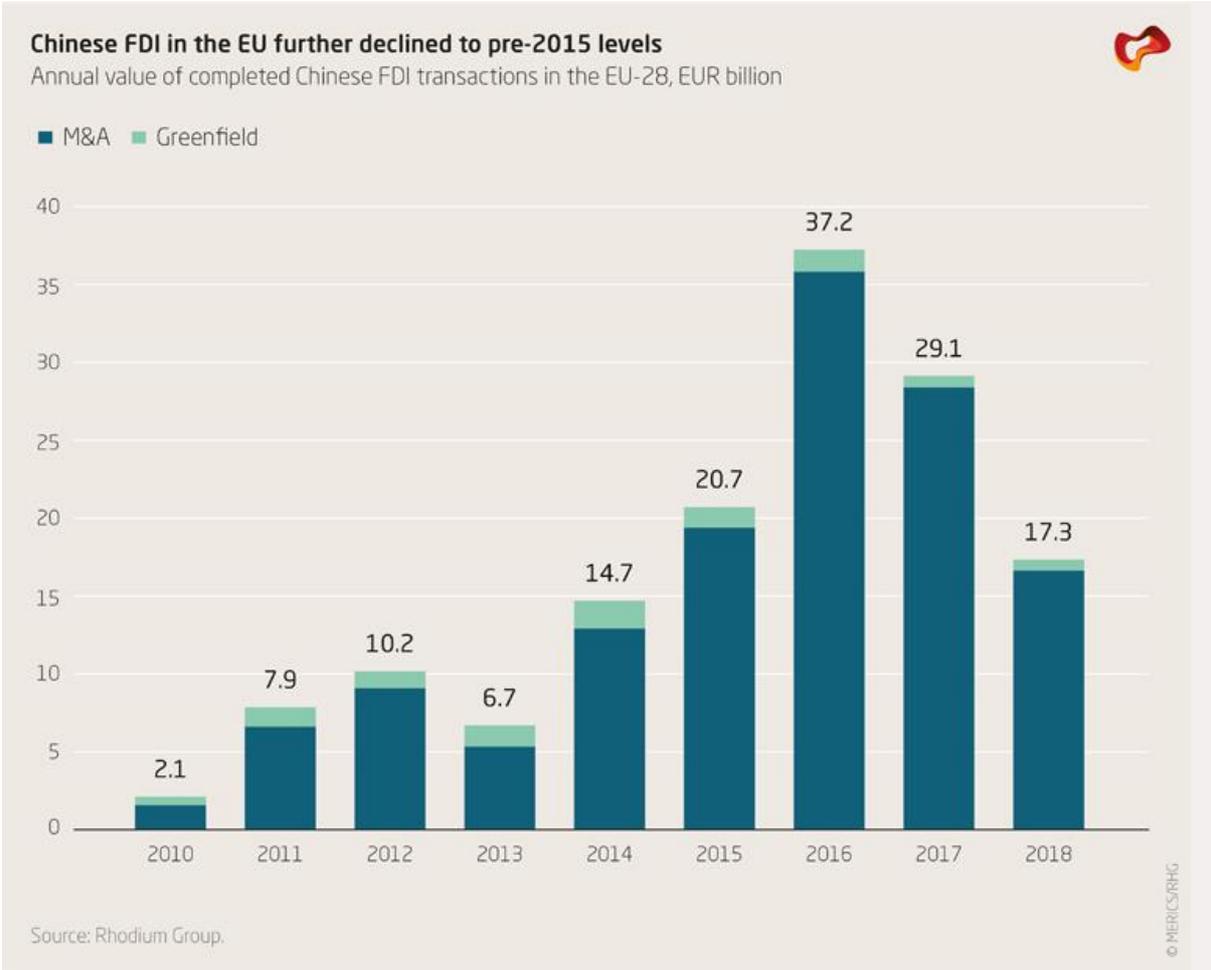
<sup>16</sup> European Commission and High Representative of the Union for Foreign Affairs and Security Policy, Joint Communication to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, “Connecting Europe and Asia – Building blocks for an EU Strategy”, JOIN(2018) 31 final, 19 September 2018, adopted by the Council of the EU on 15 October 2018.

<sup>17</sup> Such announcements were made by Wang Yi, State Councillor and Minister of Foreign Affairs, and his deputy Kong Xuanyou at the first Forum on Belt and Road Legal Cooperation held on 2-3 July 2018 in Beijing. See Xu Wei, “Beijing will work to ensure Belt, Road transparent”, *China Daily*, 4 July 2018.

<sup>18</sup> Note that later the National Development and Reform Commission (NDRC) issued the Administrative Measures for Outbound Investment of Enterprises, came into force on 1 March 2018, with the same guidelines.

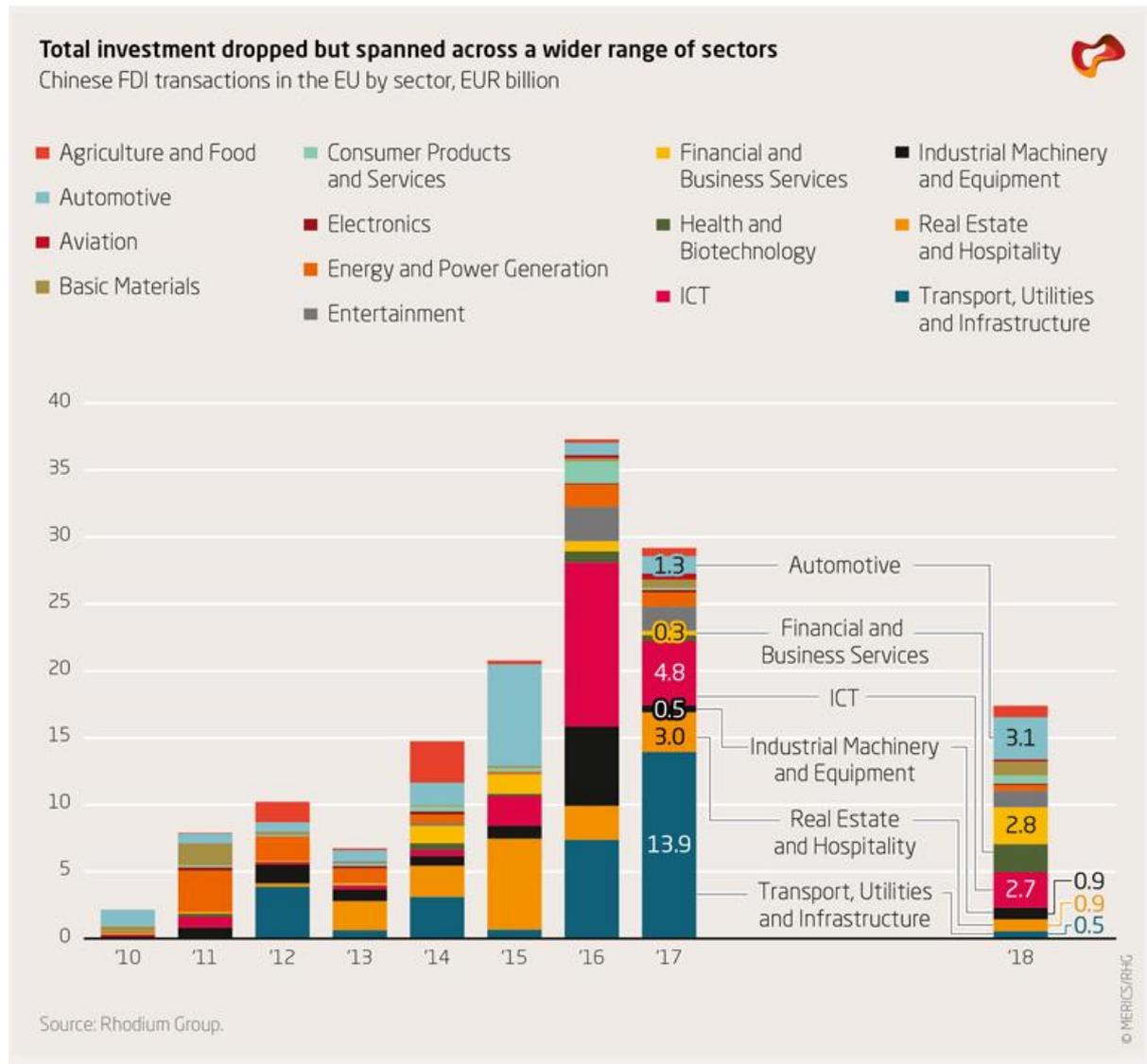
<sup>19</sup> T. Hanemann et al., “Chinese FDI in Europe: 2018 trends and impact of new screening policies”, *Merics Papers on China*, March 2019, at 9. Private investors like China’s Touchstone Capital Partners still make plans for hardware projects, like an undersea tunnel project linking Tallinn and Helsinki. See P. Goble, “Beijing Reportedly Ready to Finance Helsinki-Tallinn Tunnel”, *Eurasia Daily Monitor*, Vol. 16, Issue 34, 12 March 2019.

Figure 1. Chinese investment in the EU, 2010-18



Source: T. Hanemann et al., “Chinese FDI in Europe: 2018 trends and impact of new screening policies”, *Merics Papers on China*, March 2019, at 10.

Figure 2. Volume and sectors of Chinese investment in Europe since 2010



Source: T. Hanemann et al., "Chinese FDI in Europe: 2018 trends and impact of new screening policies", *Merics Papers on China*, March 2019, at 13.

The rise in Chinese FDI in Europe in 2013 coincided with the launch of the Belt and Road Initiative. Towards the end of its 13<sup>th</sup> five-year plan (2016-20) China is transitioning from an export and investment-reliant growth model to a slower, more sustainable and inclusive growth pattern, based more on innovation, domestic consumption and the service industry. The BRI embodies the blending of old and new approaches in the execution of this strategic vision.

There is still the investment in 'hardware' (road, rail, bridges, ports, airports, utilities and energy) along the many branches of the BRI into Eurasia, the Middle East and parts of Africa, for land, maritime, digital and space connectivity. Much of China's investment in southern and eastern parts of Europe has been in utilities and energy, or involves upgrading existing

infrastructure, such as the Port of Piraeus in Greece, where the SOE China Ocean Shipping (Group) Company (COSCO) has acquired a 51% stake of the Piraeus Port Authority (Box 1). As an integral part of the BRI, and in addition to its stake in Rotterdam and Antwerp, which amounts to 35% (143.3 million euro) and 25% (133.9 million euro) respectively, COSCO's recent expansion in the Belgian port of Zeebrugge (Box 2) has significantly increased the company's presence in the North Sea.<sup>20</sup> Such acquisitions of EU port infrastructure not only produce economic benefits to the ports concerned but also advance China's state interests in the EU, with access to strategic logistics platforms enabling further opportunities to expand business interests and, inevitably, political influence. The latter touches on the core motive of the EU's forthcoming foreign investment screening instrument (section 3.4).

*Box 1. COSCO in the Port of Piraeus*

The Port of Piraeus is the largest Greek seaport and one of the biggest in the Mediterranean Sea and Europe. Since the Greek government-debt crisis started in late 2009, the Greek government planned to privatise several state-owned assets, worth around €50 billion. One of these assets is the port of Piraeus. In October 2009 Greece leased docks 2 and 3 from the Piraeus Port Authority (PPA) to COSCO for a 35-year-period. For this COSCO pays €100 million per year. COSCO has operated Piraeus's No 2 pier since June 2010 and built its No 3 pier. In August 2015, COSCO took a 51% stake in PPA for €280.5 million. COSCO is expected to increase its stake by 16% to 67% over the next five years for an additional €88 million, if certain conditions such as completing the mandatory investments up to €300 million, are met. Economic performance of container handling has greatly improved since 2009. Before COSCO took over, the port's container handling record was at 1.5 million TEUs (20-foot equivalent units). These figures rose to 3,692 million containers in 2017.

*Box 2. COSCO in the Port of Zeebrugge*

In September 2017 COSCO acquired the remaining 76% of the stake in the APM Terminals Zeebrugge (APMTZ) for €35 million. The APMTZ has thus become COSCO's first 100%-owned terminal in northwest Europe. In January 2018, a concession agreement was signed between COSCO and the Zeebrugge Port Authority for the CSP Terminal in Zeebrugge. Subsequently, COSCO and the French shipping company CMA CGM signed an MoU for an investment of 10% in the terminal. In addition, in October 2018 the Shanghai Lingang Overseas Development Co., Ltd. signed an agreement to invest €85.3 million to establish a 30-ha logistic park.

The difficult and drawn-out infrastructure process has gone in tandem with China's ambitious aims to move beyond being the world's largest manufacturer to achieving high-technology supremacy. Ushered in by China's State Council in 2015, the 'Made in China 2025' strategy aims

<sup>20</sup> COSCO's other acquisitions of EU port infrastructure have taken place in Rotterdam, Antwerp, Noatum Port, Vado Ligure. See G. Grieger, "China's Maritime Silk Road initiative increasingly touches the EU", European Parliamentary Research Service, March 2018.

to diminish foreign technology in Chinese manufacturing and replace 70% of it with indigenous content and materials, and to create national champions in ten high-tech strategic manufacturing sectors.<sup>21</sup> The way the strategy is conceived suggests an increasingly competitive China which may soon drive Europe, the US and Japan out of their global leadership positions in technology.<sup>22</sup> This strategy explains why Chinese FDI is mainly driven by market- and strategic asset-seeking motives, why it is focused on big EU member state economies, and why it targets cutting-edge technologies.

*...the current emphasis of Chinese FDI is still on transport, infrastructure and energy projects, but gradually there is a new focus on advanced industrial machinery and equipment, ICT and (financial) technologies in key sectors identified by the 'Made in China 2025' strategy.*

Although the current emphasis of Chinese FDI is still on transport, infrastructure and energy projects, a new focus on advanced industrial machinery and equipment, ICT and (financial) technologies in the key sectors identified by the 'Made in China 2025' strategy is gradually coming online. After having been qualified by the Chinese authorities as "irrational" outbound investment that is at odds with national strategic priorities, Chinese investment in sectors such as real estate (big in London) and entertainment has seen a decline.<sup>23</sup>

Although Chinese FDI in the EU fell to €30 billion in 2017, a 17% drop compared to the year before, China's investment focus on sectors of "strategic importance" has raised unprecedented concerns in Brussels and among member states because of the risks to national security or public order that such investments entail. For the question of national security, the risks lie with Chinese SOEs, which are the main investors in Europe: 68% in 2017 (Figure 3).<sup>24</sup>

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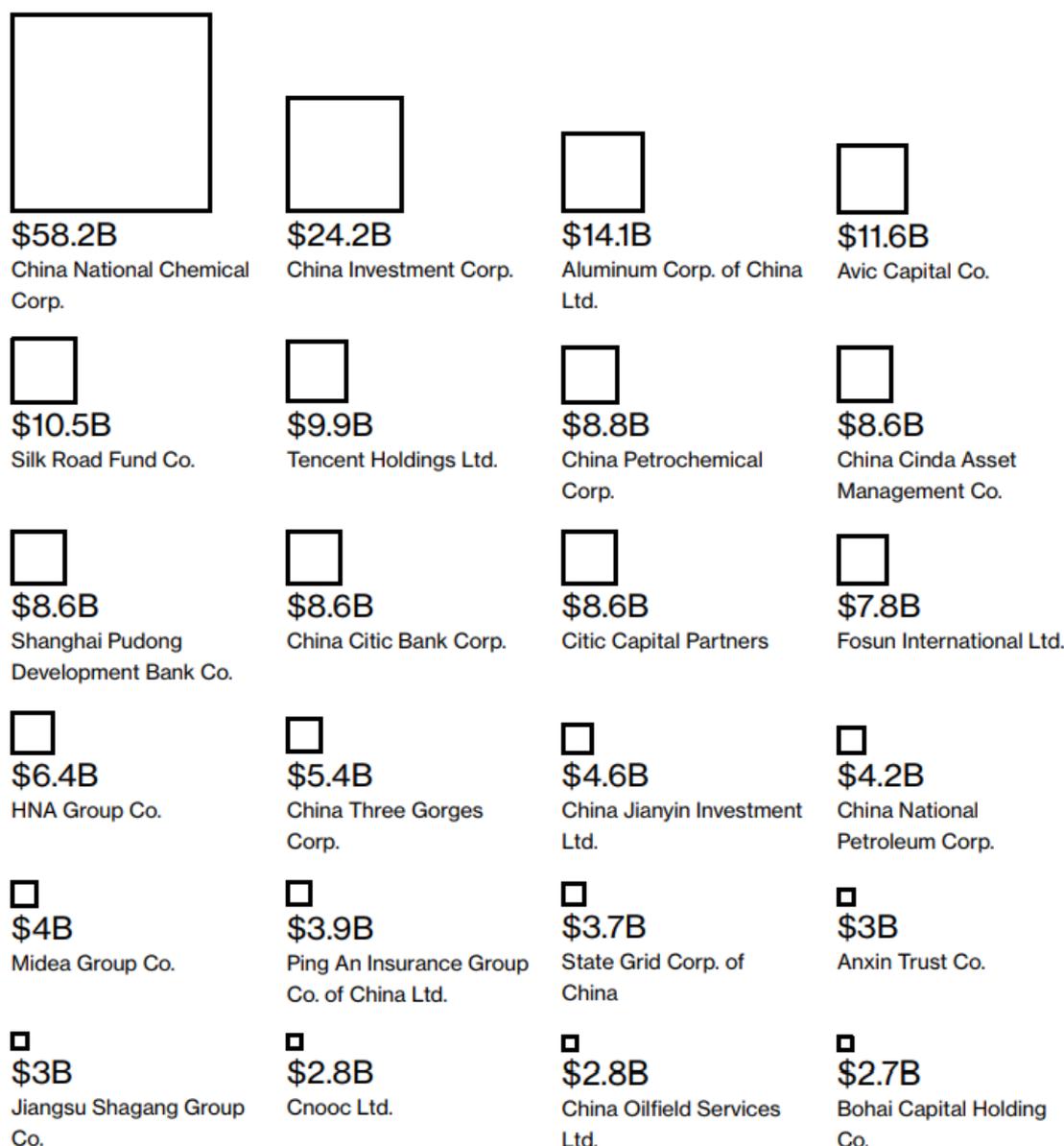
<sup>21</sup> The 'Made in China 2025' strategy envisages three steps of development: 1) in 10 years' time till 2025 - to turn China into a major manufacturing power; 2) between 2025-35 - aiming for China to reach intermediate level among the manufacturing world powers; 3) by 2049, China should be able to transform itself into the global manufacturing leader.

The ten strategic sectors targeted by the 'Made in China 2025' programme are: new information technology, numerical control tools and robotics, energy saving and new energy vehicles, power equipment, aerospace and aeronautical equipment, new materials, ocean engineering equipment and high-tech ships, biological medicine and medical devices, modern railway equipment, agricultural machinery.

<sup>22</sup> In certain sectors China already tops global charts. China's CRRC Corporation Ltd., for instance, is the world's largest supplier of rail transit equipment with the most complete product lines and leading technologies. Ranking 385 on the Fortune Global 500 List (2018), CRRC's R&D investments represent €1.408 billion, which puts it in position 96 onto the World Top 2,500 R&D Investors.

<sup>23</sup> See the outbound investment guidelines published by the State Council in August 2017. See also "China to keep monitoring 'irrational' overseas investments: state planner", *Reuters*, 18 July 2017.

<sup>24</sup> See T. Hanemann and M. Huotari, "EU-China FDI: Working Towards Reciprocity in Investment Relations", *Merics Papers on China*, No. 3, May 2018, at 30.

Figure 3. Top 25 Chinese acquirers in Europe<sup>25</sup>

The risks to ‘public order’ have to do with certain investment practices of Chinese SOEs that do not follow market principles. Although SOEs from Europe and other countries, such as the Singaporean Temasek Holdings, also invest around the globe in strategic sectors, their behaviour is expected to be based on commercial considerations and to be non-discriminatory vis-à-vis other market players.<sup>26</sup>

China-specific concerns about unfair competition are to a large extent related to the particularities of the Chinese political economy, where state interference prevails over market

<sup>25</sup> “How China is buying its way in Europe”, *Bloomberg*, 22 June 2018.

<sup>26</sup> Article XVII, GATT.

forces, and the lines between the public and the private sector are blurred. The latter took place in the wake of the first rounds of SOE reforms in the 1990s when SOEs undertook drastic measures for reorganisation, corporatisation and privatisation (stock-exchange listing), in the run-up to China's WTO accession in 2001. Granted easy access to government funds and favourable policies, Chinese SOE operations often neglect the principles at home. When competing with ordinary market players for a merger & acquisition deal abroad, a Chinese SOE would also comfortably defeat its competitors. This constitutes unfair competition, especially for private market operators, and distorts the market order.

Chinese FDI flowing into the EU also tends to arouse more suspicion about a hidden political agenda than previous waves of FDI from the US, Japan and South Korea. China's one-party state is an outlier with significant economic leverage, which promotes principles and norms that are frequently at odds with those of self-proclaimed liberal democracies, including the rule of law, transparency and fair competition. In the EU, China has a reputation for insufficient protection of intellectual property rights and for poor oversight of its export control rules (e.g. of sensitive technologies to 'rogue states' such as North Korea).

It is against this background that Europe has gradually been erecting its legal defences. Security and public order concerns linked to FDI are addressed at either the EU or member state levels through competition law, rules on state aid and public procurement. We discuss these sets of rules in turn.

### 3. European regulatory response mechanisms

#### 3.1 EU competition law

Competition law's most salient tool is the EU Merger Regulation.<sup>27</sup> The regulation is based on Article 101 of the Treaty on the Functioning of the European Union (TFEU), which prohibits cartels and anti-competitive agreements, and Article 102 TFEU, which prohibits the abuse of a dominant position. It focuses on screening mergers and acquisitions for their ensuing economic power in the relevant (geographical and product) market, so as to ensure fair and undistorted competition in the EU's single market. The enforcement of the EU Merger Regulation is shared between the European Commission and the member states' anti-trust authorities, as defined in EU law (the division is mainly based on turnover thresholds – the '*de minimis*' rule). The Commission does not shy away from investigating the most powerful companies, from state-controlled Gazprom to free-marketeering Google, for perceived abuse of a dominant position. Fines can be hefty, as shown when Facebook was fined €110 million for providing misleading information about its takeover of WhatsApp, and Google €4.34 billion for illegal practices regarding Android mobile devices to increase the dominance of its search engine. The purpose of enforcing competition rule is to make the single market work better for all companies to compete equally and fairly. Consumers, businesses and the whole European economy will

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<sup>27</sup> Council Regulation (EC) No 139/2004.

benefit as a consequence. This principle may be illustrated by the Alstom-Siemens rail merger proposal, which was blocked by the Commission in February 2019 (Box 3). The economic weight of the largest single market in the world and the Commission's tough anti-trust control has elevated the EU to the status of global norm-setter in this field.

### *Box 3. Alstom-Siemens rail merger proposal*

The Alstom-Siemens Rail Merger proposal was prompted by the increasingly dominant position of CRRC Corporation Ltd., China's railway juggernaut in the market of design, manufacture, testing, commissioning and maintenance of locomotives and rolling stock. The proposal intended to create a European rail equivalent of Airbus, with revenues of about €15 billion making it able to compete with CRRC, the world's biggest train manufacturer. Although the Commission acknowledged that European industries are facing unfair competition from state-backed companies from China, it blocked the Alstom-Siemens rail merger proposal in February 2019 because of the impending breach of EU competition rules. According to the Commission, the merger would have resulted in higher prices in signalling systems and the next generations of high-speed trains, for which Alstom and Siemens were unable to propose remedies.

The French and German finance ministers have called the Commission's decision to veto the Alstom-Siemens deal a mistake and proposed a drastic overhaul of the EU's strict competition rules, including the need to systematically base decisions on global rather than European or national market share. Reacting to those statements, the Commission has argued that, should the merger have gone through, a European champion would have been created in the above-mentioned two markets, thereby pushing customers to look for a cheaper supplier – “de facto inviting” foreign competitors like CRRC into the market.<sup>28</sup> To level the playing field with Chinese and other state-backed rivals, European Commissioner for Competition Margrethe Vestager has suggested that the EU make better use of its trade defence instruments (i.e. public procurement rules and FDI screening, see section 3.4 below) and that member states should tap into the EU programme that allows state aid for projects of common European interest.<sup>29</sup>

The main function of EU competition law is to regulate the market behaviour of all economic operators, irrespective of their origin. So far, Chinese investors have not established dominant positions in relevant European markets, any abuse of which would trip the wire of Article 102 TFEU. Whereas EU merger control also caters for the screening of acquisitions of European

<sup>28</sup> R. Toplensky, “Vestager warns against weakening merger rules”, *Financial Times*, 4 March 2019.

<sup>29</sup> See Communication from the Commission, “Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest”, OJ C 188, 20.6.2014, at 4. The programme was first used in December 2018 to approve €1.75 billion in government funding from France, Germany, Italy and the UK for a research and innovation project on sensors, chips and other micro-electronics at the heart of household and industrial devices linked to the internet (‘the internet of things’). See Commission press release No. IP/18/6862, 18 December 2018. France, Germany and Poland are considering funding a scheme to build next generation batteries for electric vehicles. The development of 5G networks could be another candidate.

companies, it does not allow the Commission to intervene against take-overs solely on the grounds that the buyer benefitted from foreign subsidies. Trade defence instruments should be able to address unfair subsidies. In view of the finding that the BRI is primarily explored and exploited by state-owned and government-controlled companies and banks from China,<sup>30</sup> it makes sense to consider EU rules on state aid and public procurement more closely and then look into investment-screening mechanisms.

## 3.2 EU rules on state aid and public procurement

### *State aid*

After the China General Nuclear Power Group (CGN) was given the green light to expand the nuclear plant at Cernavodă in Romania in 2013 – together with a 51% stake in the joint venture company (in spite of being a sole bidder in the announced tender), China’s botched attempt to woo the President and cajole the government of the Czech Republic into accepting an offer to modernise two nuclear reactors at Dukovany has taught Beijing one thing: bypassing stringent EU transparency and public procurement rules is not a given, even when dealing with a member state’s malleable leadership (Box 4).<sup>31</sup>

#### *Box 4. Upgrade and expansion of nuclear reactors in Czechia*

Czech President Milos Zeman has long fostered ties with Beijing, culminating in a state visit by President Xi Jinping in 2016 and the appointment of Ye Jianming, the founder of Chinese investment conglomerate CEFC, as Zeman’s advisor. Following the signature of a memorandum on 5 November 2016,<sup>32</sup> Czech media revealed that China pressed the Czech government to promise that CEFC would be guaranteed work on the proposed Dukovany nuclear reactor without a public tender having to take place. The scandal led the Czech government to slam the brakes and invoke EU transparency and procurement rules to open up the tender procedure. Ye has since fallen out favour of Beijing and Zeman has turned to supporting the Russian government in the bid of state-controlled Rosatom to upgrade and expand Dukovany along the same contentious lines as Hungary’s deal with Moscow over Paks II (See Box 5).<sup>33</sup> Among the other five bidders is CEFC’s competitor CGN. How the relevant actors play their cards now is critical, as a Russian- or Chinese-run expansion of nuclear energy capabilities would shape not just the Czech Republic’s geopolitical options for decades to come but also impact relations with neighbouring Austria and other EU member states.

<sup>30</sup> The cost of the Belgrade-Budapest high speed railway construction project is already estimated at \$3.6 billion (€3.18 billion). China Railway International Corporation and the Export-Import Bank of China are the project’s contractor and financier. The Hungarian State Railway is due to implement it.

<sup>31</sup> See D. Rohac, “Murky Nuclear Business in New Europe”, *The American Interest*, 12 November 2018.

<sup>32</sup> Available at [https://www.mzv.cz/file/2831905/Memorandum\\_o\\_porozumeni.pdf](https://www.mzv.cz/file/2831905/Memorandum_o_porozumeni.pdf).

<sup>33</sup> See N. Warton, “Czechs risk wrath of EU over nuclear power project”, *Politico*, 22 February 2018.

Dukovany is close to the border with Austria, where strong and well-organised opposition to nuclear energy, underscored by the country's 1978 referendum on the subject, is intent on torpedoing any expansion of existing nuclear structures in neighbouring countries through legal challenges at the EU level.

The EU places stringent restrictions on state aid to investment projects involving private parties. Article 107 TFEU denounces any aid that may distort competition or affect trade between member states. Article 108(3) TFEU therefore obliges member states to notify the Commission of any plan to grant such aid. In light of this principle and for reasons laid out above, Chinese state funding pouring into the EU is regarded with suspicion as it could harm the EU's industrial base, its long-term global competitiveness in strategic sectors, and hence its future economic prosperity.

By virtue of Article 107(3)(a) and (c) TFEU, certain state aid may, however, be found compatible with the internal market if it is granted for the purpose of supporting economic development in disadvantaged regions and for creating economic activities and jobs. To qualify, such aid must fall within the scope provided by the Guidelines on Regional State Aid for 2014-2020<sup>34</sup> and pass the compatibility assessment that is to be undertaken by the Commission after notification. The Commission will test for, inter alia, a well-defined objective of a common interest and the appropriateness and proportionality of the aid measure to address it, avoidance of undue negative effects on competition and trade, and transparency. The Commission's approval of the construction of two nuclear reactors in Hungary summarises how the state aid rules are applied within the internal market.

#### *Box 5. Paks II nuclear reactors in Hungary*

With four reactors constructed in the 1980s by the Soviet Union, the Paks nuclear plant generates approximately 50% of Hungary's domestic electricity supply. In view of the government's plan to construct two new nuclear reactors on the site, 120km from Budapest, the European Commission launched two separate investigations against the country in November 2015. The first was to assess whether Hungary's financing plan constituted state aid, in breach of Article 107 TFEU. The second investigation was for possible infringement of EU public procurement rules and procedures after the Hungarian government had directly awarded the construction of two new reactors and the refurbishment of two additional reactors to Russia's Rosatom State Nuclear Energy Corporation without launching a transparent procurement procedure.<sup>35</sup>

The total costs of the project were estimated at €12.5 billion, of which 80% would be covered by an €10 billion Russian loan and 20% by the Hungary's own contribution. Budapest insisted that because the agreements were "between private companies" they were not published in order to protect the enterprises' business interests. And because Hungary had not considered

<sup>34</sup> OJ C 209/01, 23.07.2013.

<sup>35</sup> See [http://europa.eu/rapid/press-release\\_MEMO-15-6006\\_en.htm](http://europa.eu/rapid/press-release_MEMO-15-6006_en.htm).

using public money, for the risk of breaching EU state aid rules, it had not expected the Commission to launch a probe into the funding of Paks II.<sup>36</sup>

As a result of the first investigation, the Commission concluded in March 2017 that Hungary's financial support for the construction of the Paks II project did amount to state aid within the meaning of Article 107(1) TFEU, as the Hungarian state would accept a lower return on its investment than a private investor would, while the EU rules require state aid to be limited and proportionate to the objectives pursued in order to be approved. The Commission nevertheless approved the financial support because the Hungarian government had promised to limit distortions of competition, including avoiding market concentration.<sup>37</sup>

As a result of the second investigation, the Commission dropped infringement proceedings against Hungary. The Commission found that, while the Russian investor in the Paks II project had been selected without calling a tender, Hungary had not violated EU directives which allow for public procurement without competition if the contract can only reasonably be given to one company. The Commission noted that Hungary had sufficiently justified that its use of the 'technical exclusivity exemption', which caters for the situation that the technical and safety requirements of the project can only be met by one company, was compatible with EU law so as to award the contract directly. The Commission's decision was widely criticised for letting technical requirements prevail over the protection of general interest and is now being challenged by Austria for breaching EU state aid rules.

EU rules on state aid are likely to be applicable to China's major investments in transport and energy infrastructure along the BRI branches that stretch into the European Union, especially when the investment comes in the form of a loan that is granted to a BRI project through an inter-bank on-lending facility between, for example, the China Development Bank and a national bank of a member state.<sup>38</sup> To be exempted from the prohibition to give state aid, criteria such as economic development and job creation must be met. After that, a relevant Chinese investment must pass the compatibility assessment of regional aid, and questions such as appropriateness and proportionality of the financial assistance must be answered with satisfaction before the Commission may grant a waiver. Note that within the context of the internal market, state aid means any aid, regardless of its form, granted to certain undertakings by national public authorities. Within this context, the Commission's investigation and clearance of the BosodChem project is a case in point (section 1).

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<sup>36</sup> For details, see <https://budapestbeacon.com/hungary-russia-sign-3-implementation-agreements-paks-ii/>.

<sup>37</sup> See State Aid: Commission clears investment in construction of Paks II nuclear power plant in Hungary, European Commission Press Release, Brussels, 6 March 2017.

<sup>38</sup> For example, the China Development Bank (CDB) sponsored the establishment of the China-CEEC Interbank Association. It is revealed that, in May 2017, through an €79 million on-lending loan of Hungarian Development Bank, the CDB provided funding support to Wanhua-BorsodChem for constructing the chlorine production line, thus delivered the first instalment of the in the Sino-Hungary €1 billion loan facility cooperation. See the Annual Report 2017, China Development Bank, at 49.

## *Public procurement*

As indicated above, Chinese companies are bound by EU public procurement rules, which are based on the principles of transparency, non-discrimination and competitiveness. The EU public procurement regime eradicates non-tariff barriers in the single market and guarantees open and fair access to the procurement of goods and services, one of the fundamental freedoms of the single market. This is also in the interests of member states as they will be able to acquire ‘value for money’ and efficient use of public funds.

The EU public procurement regime is presently governed by Directive 2014/24/EU of 26 February 2014 on public procurement, which is also known as the classical Directive,<sup>39</sup> Directive 2014/25/EU of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors,<sup>40</sup> and Directive 2014/23/EU of 26 February 2014 on the award of concession contracts, but only with a value equal to or greater than €5 million.<sup>41</sup> Within the remit of the EU public procurement directives, all undertakings, either public or private, are guaranteed participation in procurement tendering, as long as a public undertaking tenderer’s participation does not cause any distortion to competition vis-à-vis private undertaking tenderers. With regard to the eligibility of public undertaking tenderers, directly or indirectly subsidised undertakings by a state (or other contracting authorities or even by the contracting authority itself) may legitimately take part in a tender.<sup>42</sup> The criterion that may disqualify a tenderer includes “abnormally low tenders”,<sup>43</sup> or if a tenderer violates relevant labour and environmental legislation. For the former, contracting authorities may reject those tenderers if it is proved that they are recipients of illegal state aid. Given that supporting social responsibility is an aim of the new EU public procurement system, ‘social inclusion’ as well as ‘social and labour legislation compliance’ have now become awarding criteria, to encourage companies to develop socially responsible products and services. As a result, some of the previous awarding factors, such as ‘the most economically advantageous offer’ approach, considered as a legitimate discretion that contracting authorities might have exercised in the past, will no longer be an awarding criterion alone. Instead, the approach has become ‘best value for money’. Specifically, contracting authorities will be able to better take social aspects into account on awarding procurement contracts on the basis of the ‘best price-quality ratio’. That means a contracting authority can choose the tenders that promote gender equality,

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<sup>39</sup> OJ L 94/65, 28.03.2014. The Directive coordinates procurement of goods, services and works, for which procurement may be undertaken by central government and sub-central contracting authorities, respectively. Thresholds under the classical Directive depend on the kind of procurement items – goods, services or works – as well as on the procuring authority, which are determined by Regulation (EC) 1336/2013.

<sup>40</sup> OJ L 94/243, 28.03.2014.

<sup>41</sup> OJ L 94/1, 28.03.2014.

<sup>42</sup> Case C-94/99, ARGE Gewässerschutz v. Bundesministerium für Land und Forstwirtschaft [2000] ECR I-11037.

<sup>43</sup> Under such circumstances, the CJEU ruled, with direct effect, that contracting authorities should examine the details of the bid before deciding to award a contract and seek from the tenderer explanations as to the bid submitted. Case 76/81, SA Transporoute et Travaux v. Minister of Public Works [1982] ECR I-457.

work-life balance or provide more social advantages, including employing long-term unemployed or disadvantaged people to carry out the contract.

At member state level, and as far as subcontracting is concerned, national contracting authorities must ensure that tenders comply with environmental, social or labour law obligations under EU or national rules, or international agreements. This implies that transparency must be ensured throughout the entire subcontracting procedure, from the stage of call for tenders to the performance of the contract; while at the same time a chain of responsibilities may be drawn up when subcontracting subcontractors.

Under the current rules, projects with third countries are implemented through international agreements. Under such agreements, the parties can agree on specific procurement rules. In this case, the EU procurement instruments are not applicable, but such specific procurement rules must comply with basic treaty principles of transparency and equal treatment.<sup>44</sup>

It is acknowledged that Chinese investors possess certain qualities, such as technical expertise, efficiency and a can-do attitude which are highly valuable, especially for large infrastructure projects. But due to the massive state funds that they are provided with, a chief legal obstacle that Chinese investors face in public procurement tenders in Europe is 'low price'.<sup>45</sup> And this may disqualify their bids since an abnormally low bid, amounting to dumping, is not seen as being compatible with the 'best value for money' approach adopted by the EU public procurement rules, and principles such as fair competition may also be brought to question the legitimacy of a Chinese SOE's bid. The saga of the Pelješac bridge in Croatia illustrates this misgiving (Box 6).

#### *Box 6. Pelješac bridge in Croatia*

The Pelješac bridge project aims to connect the southernmost part of Croatia around Dubrovnik to the rest of mainland Croatia, bypassing the 12km stretch of Bosnia and Herzegovina which interrupts the Croatian coastline at Neum. The bridge itself will be 55m high and 2.4km long, with four lanes. The works are expected to be completed in 2022. The controversy around the construction of the bridge boils down to a Chinese SOE's abnormally low bidding price and

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<sup>44</sup> The EU's Strategic Outlook for China states that, "a more strategic approach to the EU's procurement framework could help to identify and address obstacles and loopholes that impede a level playing field in (global markets). For instance, the rules could be revised or their application strengthened in order to ensure that procurement procedures conducted in the EU on the basis of international agreements comply with the (EU legal) principles (such as) transparency and equal treatment." See JOIN(2019) 5 final, 12 March 2019, at 7.

<sup>45</sup> See G. Grieger, "China, the 16+1 format and the EU", European Parliamentary Research Service, September 2018. Bad lending practices include Chinese loans that do not envisage public tenders but are usually tied to a Chinese SOE, a high-level involvement of Chinese workers, material and equipment, and easily lead to fiscal instability as a result of the "quick and easy money" made available with "no strings attached" and, therefore, without demand for good governance, environment sustainability, etc.

winning a major construction contract, of which 85% of the cost is funded by the EU for €357 million.<sup>46</sup>

The contract for the first phase of the construction of the Pelješac Bridge and access roads was awarded in January 2018 to a Chinese consortium led by the China Road and Bridge Corporation (CRBC). With 2.08 billion kuna (€283 million), the CRBC not only outbid the competing rivals Strabag of Austria (2.62 billion kuna) and a Turkish-Italian consortium comprising Astaldi and IC Ictas of Turkey (2.55 billion kuna), it also committed to build the bridge in three and a half years, i.e. six months ahead of schedule.

Strabag and Astaldi-IC Ictas each lodged a complaint to the State Commission for Supervision of Public Procurement Procedure (DKOM) for the unusually low winning bid submitted by CRBC. They alleged that the bid from CRBC was backed up by Chinese state aid, that this contravened EU competition rules, and that therefore the DKOM had an obligation to establish a case of dumping. The complaint was dismissed as unfounded by the DKOM in March 2018. Strabag subsequently filed an application at the Administrative Court in Zagreb in April 2018, with the aim of suspending the construction of the Pelješac bridge, but that application too was turned down.

So far, Bosnian arguments raised against the decisions of the Croatian government and the European Commission have not produced any result.

The examples in this section have shown that EU rules on state aid and public procurement suffer from two major deficiencies: they only cover aid granted by member states and do not fully address the effects within the single market of subsidies granted by foreign governments; nor is there a systematic and centralised FDI screening on security grounds at EU level. Among the 28 EU member states, a majority of them have no screening mechanism and in 12 member states with such a mechanism, there are significant differences. We will discuss these issues in turn, first by focusing on what scope for FDI screening exists at the level of the member states, and then by analysing the new regulation that will create an EU-wide FDI screening mechanism.

*EU rules on state aid and public procurement suffer from two major deficiencies: they only cover aid granted by member states and do not fully address the effects within the single market of subsidies granted by foreign governments.*

### 3.3 FDI screening mechanisms

#### *National level*

Neither of the above regulatory mechanisms (i.e. EU competition law, rules on state aid and public procurement) examines whether FDI from private or public sources may benefit from foreign state funding for the implementation of national industrial policy goals. As a result,

<sup>46</sup> See “Commission approves EU financing of the Pelješac bridge in Croatia”, Press release, European Commission, Brussels, 7 June 2017.

there has been a growing perception among certain member states that the existing mechanisms are too weak to tackle concerns about alleged ‘unfair competition’ at the national level.

Having said that, by virtue of Article 21 of the EU Merger Regulation, member states have the exclusive competence to scrutinise, and therefore to take proper measures with regard to, acquisitions in order to protect national interests on the grounds of public security, plurality of the media and prudential rules, also known as “recognised interests”, in the defence, media and financial services sectors.<sup>47</sup> The remit of “recognised interests” may expand, and if a member state wishes to adopt certain measures pursuant to a scrutiny the Commission must be notified before the measures may be implemented.

The EU treaties provide two legal bases for the exemption of application of EU law to member states’ national security reviews:

- Article 346(1)(b) TFEU, which excludes the national defence sector, and hence measures that the member states consider necessary for the protection of essential interests of their security, from the application of the EU treaties; and
- Article 65(1)(b) TFEU, as a derogation from the fundamental principle of free movement of capital and payments as enshrined in Articles 63-66 TFEU.

Whereas the former legal basis is rather straightforward, the latter has led to more than one dispute being brought before the Court of Justice of the European Union (CJEU).

Unlike the other three freedoms of the internal market, involving the free movement of persons (including the free movement of workers and the freedom of establishment), goods, and services, the free movement of capital extends to third countries as well. Article 63(1) TFEU provides that: “all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited”. Exceptions from its broad scope have been interpreted narrowly by the CJEU in its settled case law, notably the jurisprudence on member states’ ‘golden share’ arrangements (special shares held in privatised former state-owned enterprises). There are two possibilities for EU member states to restrict the free movement of capital: by invoking grounds of public policy or public security explicitly mentioned in Article 65(1)(b) TFEU, which, however, may not constitute “a means of arbitrary discrimination or a disguised restriction of this freedom”; and by invoking overriding reasons relating to the general interest (environmental protection, town and country planning, and consumer protection), as recognised by the CJEU.

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<sup>47</sup> Otherwise, under Article 21 of the Merger Regulation, the Commission has exclusive competence to assess the competitive impact of concentrations with a Community dimension. In this respect, see also Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC, OJ L 216/76, 20.08.2009.

Thus, member states cannot unilaterally determine the scope of public security without any control by the EU institutions. They may rely on the public security exception only in the presence of a “genuine and sufficiently serious threat” to a fundamental interest of society. This exception must not be applied for purely economic ends; investors must have an opportunity to challenge the decision before a court. Restrictive measures must satisfy the proportionality test; that is, they must be necessary to achieve the objectives and there must be no less restrictive measure that is equally effective.<sup>48</sup> The CJEU has recognised a few strategic sectors, such as oil, telecommunications and electricity as vulnerable in this regard, but has significantly limited member states’ discretion.<sup>49</sup> Following the above-mentioned logic of EU competition rules, it is up to the member states to invite the European Commission to screen their proposed deals with (enterprises owned by) third states in these strategic sectors.

At present, 12 member states<sup>50</sup> have a legal framework for scrutiny in place or have performed case-by-case reviews for reasons of national security or restrictions on qualifications of expatriates and reciprocity (Figure 4). The 12 FDI scrutiny mechanisms differ in design and scope, for example in terms of prior authorisation and *ex post* screening. Among the existing FDI screening mechanisms, screening thresholds differ from 5 to 50%; some member states determine the sectors for screening while others do not; and some confine screening to national security while others go beyond this. Also, some member states insist on reciprocity, in order to require favourable business considerations to be obtained via bilateral cooperation on market access. Some countries undertake reviews because of partial or total prohibitions of, or restrictions on, FDI in specified sectors.

Those member states embracing a narrow interpretation of national security (limited to the weapons industry), such as Denmark, Sweden, and Slovenia, have introduced restrictions under a specific legal basis. The prevailing approach uses case-by-case scrutiny, while automatic scrutiny is mostly linked to the requirement to hold a licence for a commercial activity, such as the production of weapons. Ireland has no formal screening mechanism but prohibits foreign (and domestic) investment in the armaments sector. Denmark has both a formal scrutiny procedure for the weapons industry and excludes FDI from its gas and electricity infrastructure, which must remain public property. In Spain and Sweden, screening is mandatory for the defence sector, while it is run case-by-case for other sectors.

In recent years, several member states, including Finland, France, Germany, Italy, Poland, Portugal and the UK have revised their FDI screening procedures to determine whether essential security interests or public order are endangered by impending acquisitions. Huawei is currently being scrutinised in several member states (e.g. Czechia and the UK), as well as the

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<sup>48</sup> C-54/99 *Scientology Church*, paragraphs 17 and 18; C-483/99 *Commission v France*, paragraph 48; C-503/99 *Commission v Belgium*, paragraph 47, C-463/00 *Commission v. Spain*, paragraph 72.

<sup>49</sup> The CJEU has so far only approved the Belgian model in C-503/99 *Commission v Belgium*, paragraphs 46-55.

<sup>50</sup> Austria, Denmark, Finland, France, Germany, Italy, Latvia, Lithuania, Poland, Portugal, Spain and the UK.

US, Australia and New Zealand, in light of potential threats to national security and cybersecurity for its stakes in 5G network infrastructure, equipment and services (Box 7).

*Box 7. Huawei, a potential threat to national security and cybersecurity?*

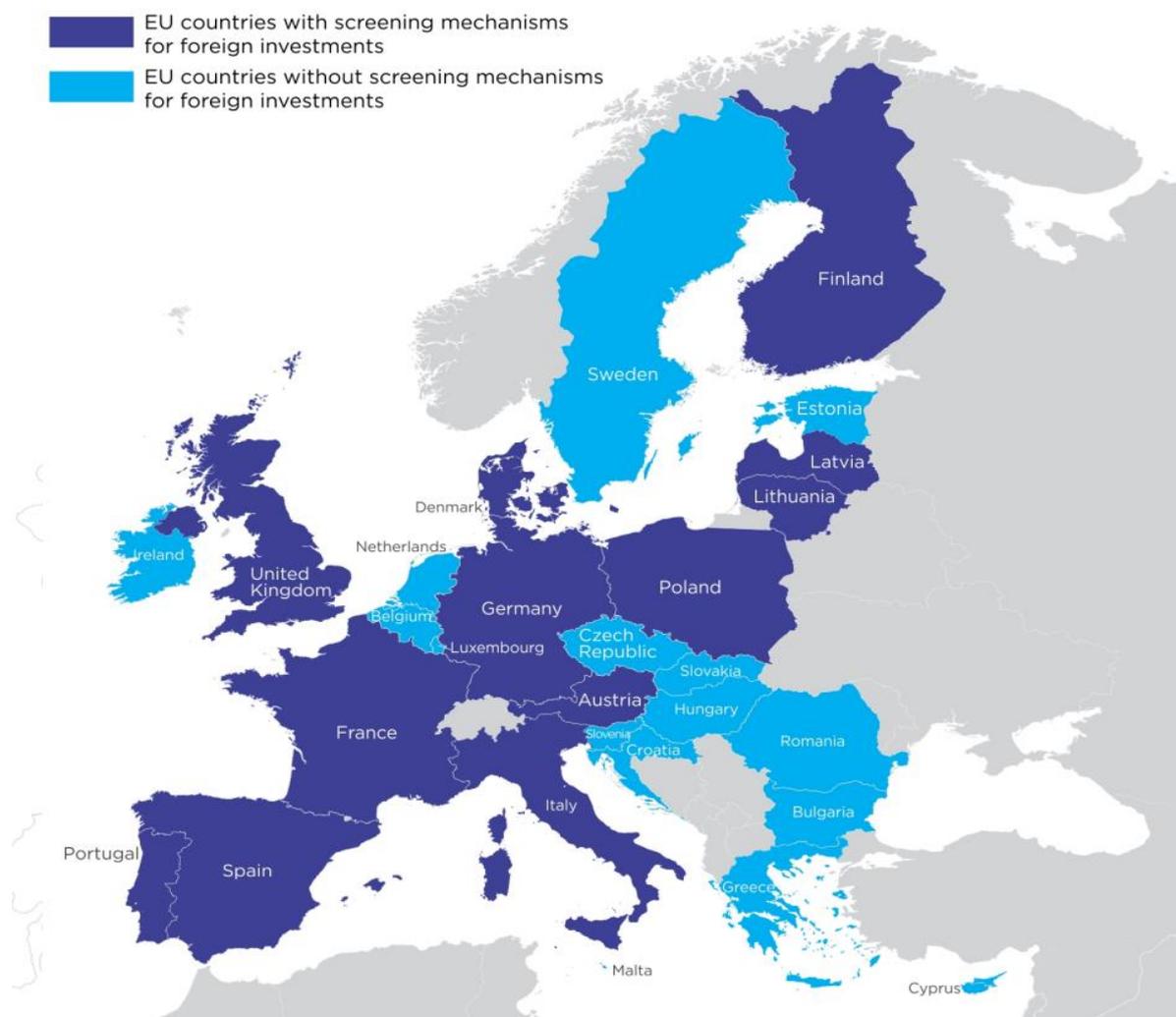
Given the critical function of 5G wireless networks upon which, for example, the running of future smart cities will depend, a potential breach of national security is a legitimate concern. While governments monitor each other, individuals' privacy and business activities are generally protected. The US-China Cyber Agreement of September 2015 bears testimony to this norm. Article 77 of China's National Security Law (2015), however, does not differentiate between spying on states and individuals. It obliges Chinese citizens and companies like Huawei to provide leads and evidence that may harm national security. Huawei's potential threat to third countries national (cyber)security is further aggravated if one considers that China's Cybersecurity Law requires companies to also disclose data localisation and source codes. Article 37 requires that personal information and important data collected and generated by critical information infrastructure operators in China (e.g. public communications and information services, energy, finance, transportation, water conservation, public services and e-governance, as well as other critical information – by virtue of Article 31) must be stored in China. If an overseas transfer is required due to business needs, a security assessment will be conducted and all relevant laws will apply. Moreover, Article 23 stipulates that critical network equipment and special cybersecurity products can only be sold or provided after being certified by certified establishments.

Although such requirements may be warranted to safeguard cybersecurity, foreign ICT enterprises are most worried, for two reasons. First, they may suffer discrimination with regard to their business opportunities for supplying ICT equipment and services in China. It is alleged that, since 2015, the Chinese government has increasingly been requiring the use of "secure and controllable" or Chinese- developed and/or controlled ICT products, solutions, and services based on "cybersecurity" justifications. Second, foreign ICT enterprises are concerned that it would become mandatory for vendors to file sensitive IP, such as source code, with the Chinese government in order to obtain security clearance. Source code often contains sensitive information, be that configuration-related information (e.g. database credentials) or information on how the web application functions. If disclosed, such information could be used by an attacker to discover logical flaws and escalate into a subsequent chain of attacks that would otherwise be impossible without access to the application's source code.

Against this legal backdrop, one cannot dismiss Huawei's global role in telecommunications, its competitive capacity in innovation, manufacturing and infrastructure. In recent years, Huawei has been one of the top three international patent applicants. In 2017, Huawei was the world's number one filer under the Patent Cooperation Treaty. ZTE was second, followed by Intel, Mitsubishi and Qualcomm. Huawei is also poised to become the world's largest supplier of 5G infrastructure. The company has been particularly adept at getting its patents adopted by 3GPP (3rd Generation of Partnership Project, a collaboration between groups of telecoms standards associations, known as the Organisational Partners) and the International Telecommunication Union, two of the major groups that establish international telecom protocols.

Following the successful Chinese takeover of Kuka by Midea (Box 8) and the withdrawal of the initial clearance for the takeover of Aixtron by a Chinese state-backed consortium (Box 9) in 2016, the Federal Ministry for Economic Affairs and Energy of Germany in July 2017 tightened the Foreign Trade Ordinance and introduced obligations to report foreign takeovers of German companies in various areas of critical infrastructure, including defence and IT security (and cryptographic equipment). The second pillar of the German FDI screening mechanism is cross-sector scrutiny that may be triggered by the acquisition of more than 25% of voting rights in the company to be acquired, although the latter is only applied to investments from non-EU and non-European Free Trade Association countries. Similarly, the UK adopted changes to its investment-screening mechanism in June 2018, requiring notification of mergers pertaining to the development or production of ‘dual use’ items, the design and maintenance of aspects of computing hardware, and the development and production of quantum technology. The new rules apply to businesses with a UK turnover of more than £1 million, up from £70 million.

Figure 4. EU member states with an investment-screening mechanism



Sources: Rasmussen Group, “Foreign Investment Screening and the China Factor: New protectionism or new European standards?”, 16 November 2017 and European Commission 2017.

This patchwork of different mechanisms for screening FDI on national security grounds currently in place in nearly half of the member states, coupled with the scrutiny of mergers and acquisitions under EU competition rules, has sparked a debate whether Union-level tools should be developed to adequately tackle the newly perceived challenges posed by the BRI to all member states, i.e. not just those involved in the '16+1 format'.

*Box 8. Kuka – Midea’s takeover after obstacles cleared*

Founded in 1898 and described as a “crown jewel” of German industry, Kuka is a leading manufacturer of industrial robots and automated productions systems supplying several industries, including automotive, medical, solar, and aerospace equipment. Kuka’s sales revenues were just under €3 billion in 2015.

In May 2016, Midea, a domestic appliance manufacturer based in Guangdong Province, China, offered to acquire more than 30% of Kuka shares with a value of about €4.5 billion. In an effort to prevent Midea’s takeover the German government unsuccessfully tried to put together a consortium of German/European investors to buy Kuka. Kuka’s own management and supervisory board, and certain shareholders, also opposed Midea’s takeover proposal. But Midea’s offer proved too attractive to resist. Valid until 2023, i.e. longer than a usual commercial agreement, Midea’s investment agreement guaranteed Kuka staff job security and committed to protect business partners’ data, high investment in R&D, as well as to let it operate independently and help it expand in China, etc.

In order to mitigate the potential security threat involved in the takeover, Kuka sold its American business KUKA Systems Aerospace North America, which engaged in highly sensitive military-related activities covered by the International Traffic in Arms Regulations (ITAR), to US automation company Advanced Integration Technology Inc. Note that China has been prohibited from ownership of ITAR-registered companies since 1989. The Committee on Foreign Investment in the US (CFIUS) and the Directorate of Defense Trade Controls granted their approval for Midea’s takeover. Thus, all closing conditions of Midea’s tender offer were met. The takeover took effect in the first half of January 2017.

*Box 9. Aixtron: takeover bid failed on security grounds*

Founded by three employees of the German Institute for Semiconductor Technology, Aixtron makes devices that produce crystalline layers based on gallium nitride that are used as semiconductors in weapons systems. Its technology is being used to upgrade US and foreign-owned Patriot missile defence systems. In 2016 it was revealed that Aixtron had suffered financial difficulties; its first quarter results in 2016 saw a 47% year-on-year drop in revenues and 65% drop in profits - although its annual revenues over the previous years showed a consistent, if small, improvement. In May of that year, a consortium of Chinese investors, incl. Grand Chip Investment GmbH, Grand Chip’s parent companies Grand Chip Investment S.a.r.l., Fujian Grand Chip Investment Fund LP, Fujian Grand’s partners, and Xiamen Bohao Investment

Co. Ltd. offered to buy Aixtron for €670 million. The acquisition was partly funded by China IC Industry Investment Fund, a state-controlled entity in China.

One month after the initial approval was granted in September 2016, the German authority withdrew clearance for the takeover. Aixtron's US business includes a subsidiary, Aixtron Inc., that is headquartered in California. Following an assessment undertaken by CFIUS and citing security concerns of "the military applications of the overall technical body of knowledge and experience of Aixtron", the Obama Administration blocked Fujian Grand Chip Investment from buying Aixtron US. Eventually, the Chinese investors' offer to acquire Aixtron was withdrawn. Aixtron commented that it was now up to the government to support Germany's technology industry and employees, for example by setting up an investment programme.

Concerns about unfair competition from China through bids that cross between private investment and state-orchestrated takeovers (see the failed Aixtron takeover), have added to longstanding worries about the persistent lack of reciprocal access for EU companies to the Chinese market. Whereas by virtue of the 'Catalogue Guiding Foreign Investment in Industry' jointly issued by the National Development and Reform Commission (NDRC), China's top economic planning body, and the Ministry of Commerce, numerous sectors are prohibited (e.g. rare earth mining and tobacco), restricted (e.g. cloud computing) or limited to partnerships with Chinese companies (e.g. oil and gas), they are almost entirely open to Chinese firms in the EU.<sup>51</sup> In addition, approval of FDI in China may still be subject to case-by-case scrutiny, at provincial and city level, creating uncertainty and arbitrariness.

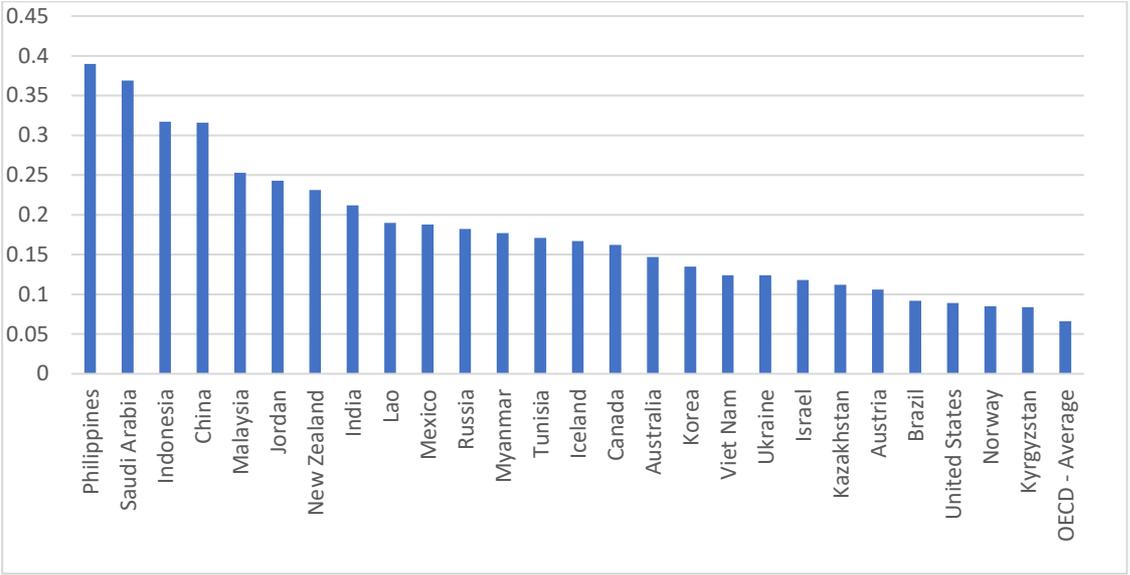
*Whereas in China numerous sectors are prohibited (e.g. rare earth mining and tobacco), restricted (e.g. cloud computing) or limited to partnerships with Chinese companies (e.g. oil and gas), they are almost entirely open to Chinese firms in the EU.*

The overall FDI restrictiveness faced by foreign investors in China may be best depicted by the two figures<sup>52</sup> below.

<sup>51</sup> Note that the Catalogue may be updated on an ad hoc basis, especially in order to feed into the 5-year plan.

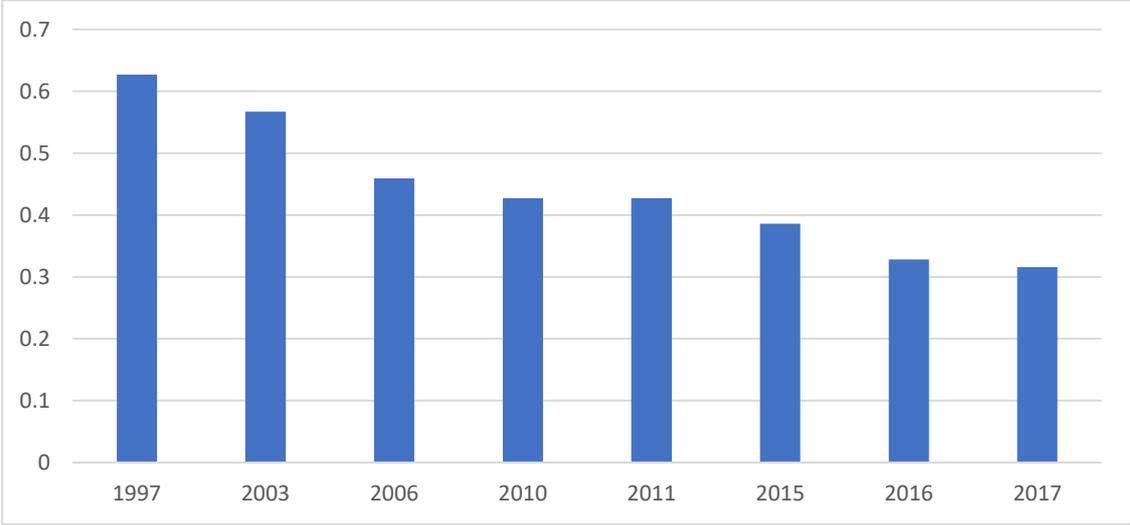
<sup>52</sup> Thanks to Mattia Di Salvo (CEPS), using OECD 2018 data.

Figure 5. OECD FDI Regulatory Restrictiveness Index 2017



In 2017, as in previous years, China was one of the most FDI restrictive countries among 62 countries surveyed by the OECD.

Figure 6. China FDI Regulatory Restrictiveness Index 1997-2017



Between 1997 and 2017, FDI restrictiveness in China nearly halved, though changes are minimal in recent years.

This asymmetrical situation and the perceived regulatory gap on the side of member states and EU competition law triggered a debate in Brussels about the need for legislative action to create a new EU-wide FDI screening mechanism.<sup>53</sup> The mood around Europe has also grown more defiant in the face of the world's emerging hegemon. French President Emmanuel Macron stated during his visit to China in January 2018 that the Belt and Road Initiative could not be one way. Macron pushed Beijing to increase market access for French companies. Weeks later, German Chancellor Angela Merkel insisted that Germany remained committed to free trade but that it must be reciprocal. Yet, it is mainly EU institutions and capitals around Western Europe that are beating the drums; not so much the EU member states belonging to the 16+1. Given the diverging approaches and the need for better coordination, member states' mechanisms should be replaced by a new consistent FDI screening mechanism at EU level vis-à-vis third countries.

### *EU-level*

The underlying philosophy of an EU-wide screening mechanism is that better coordination of national policies is contingent on a common legal framework to protect essential strategic interests, increase legal certainty and ensure transparency, while sustaining one of the most open investment regimes in the world. Although some experts have stressed that positive reciprocity rather than return harm should be privileged,<sup>54</sup> the prevailing sentiment in Brussels is that a transparent EU-wide mechanism would provide certainty for investors and eliminate the inconsistencies of the current patchwork system. Insisting on transparency should also ensure fair competition within the remit of public procurement rules, not least because it is clear who buys in Europe and where the money comes from. A common review system would allow the identification of sectors that are vital for EU security, and where the concentration of economic power by non-EU investors risks being abused.

*The underlying philosophy of an EU-wide screening mechanism is that better coordination of national policies is contingent on a common legal framework to protect essential strategic interests, increase legal certainty and ensure transparency, while sustaining one of the most open investment regimes in the world.*

The debate was launched officially in February 2017 by the French, German and Italian ministers of the economy with a common letter to EU Commissioner for Trade, Cecilia Malmström. On 13 September 2017 the European Commission, to coincide with Commission President Jean-Claude Juncker's State of the Union speech, unveiled a draft regulation on

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<sup>53</sup> See, e.g. Commission Decision of 29 November 2017 setting up the group of experts on the screening of foreign direct investments into the European Union, C(2017) 7866 final. In his speech before the European Parliament on 17 April 2018, French President Macron gave new political impetus to plans to develop an EU-wide FDI screening mechanism. See <https://www.elysee.fr/emmanuel-macron/2018/04/17/speech-by-emmanuel-macron-president-of-the-republic-at-european-parliament.en>.

<sup>54</sup> This would imply that FDI screening must be limited to national security considerations and that it must exclude economic security issues.

foreign direct investments in the EU.<sup>55</sup> By November 2018, the Parliament, the Council and the Commission had agreed on the framework of the FDI screening. The Council formally adopted the Regulation on 5 March 2019,<sup>56</sup> will enter into force in April and will fully apply in November 2020.<sup>57</sup>

The new instrument is expected to detect and raise awareness of foreign investment in critical assets, technologies and infrastructure. It will further allow for security and public order threats posed by acquisitions in sensitive sectors to be identified and addressed collectively. The framework prioritises cooperation between the Commission and the member states, enables the Commission to issue non-binding opinions on investment concerning several member states or when an investment could affect the “Union interest” (e.g. H2020 or Galileo), but leaves untouched member states’ competence to decide whether a particular investment threatens national security interests or public order. Member states will retain the power to review and potentially block FDI on security and public order grounds. In this way, they will not be required to adopt an FDI screening mechanism if they do not have one. However, existing and new mechanisms will have to respect a number of EU-wide norms, such as the non-discrimination principle; the protection of confidential information; the right to judicial redress against national authorities’ decisions or clearly defined applicable procedural rules. Member states should use the period between entry into force and the start of application of the Regulation to make the necessary changes to their national domestic practices and legislation and put in place the administrative structures to ensure effective cooperation at EU level with the Commission, in accordance with the established mechanisms.

In reviewing FDI on the above-mentioned grounds, a member state may consider the potential effect of the investment on areas including:

- Critical infrastructure (including energy, transport, communications, data storage, space or financial infrastructure, as well as sensitive facilities);
- Critical technologies (including artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity, space or nuclear technology);
- Security of supply of critical inputs; or
- Access to sensitive information or the ability to control sensitive information.

By way of further clarification, the FDI screening instrument provides that in determining whether a foreign investment is likely to affect security or public order, member states may

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<sup>55</sup> European Commission, Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, Brussels, 13 September 2017, COM(2017) 487 final.

<sup>56</sup> Council Press Release, “Council greenlights rules on screening foreign direct investments”, 5 March 2019. For the draft Regulation see European Parliament and Council of the EU, PE-CONS 72/18, 2017/0224 (COD) Brussels, 20 February 2019.

<sup>57</sup> Regulation of the European Parliament and of the Council establishing a framework for the screening of foreign direct investments into the Union (not yet published in the Official Journal).

take into account whether the foreign investor is controlled by the government of a third country, including through significant funding. In this sense, while the regulation would not be limited to covering investments by state-backed investors, such investors may find themselves subject to a greater degree of scrutiny. Ultimately, the list is non-exhaustive and includes a broad framework within which member states may choose to screen a planned foreign investment.

The framework also builds in certain basic protections for foreign investors. This includes non-discrimination between different third countries, transparency and judicial review – although the extent of this will clearly differ according to member states’ own legal systems. To ensure the effectiveness of the review mechanisms, it also allows member states to maintain, amend or adopt measures necessary to prevent their circumvention. This would include, for example, the possibility for member states to review investments by European-domiciled companies that are owned or controlled by a foreign investor, or artificial arrangements within the EU that do not reflect economic reality and that are designed to circumvent the review mechanism.

Ultimately, finding the right balance of policy approaches is a matter of political judgement. As mentioned in the EU’s new Strategic Outlook on China,

“neither the EU nor any of its Member States can effectively achieve their aims with China without full unity. In cooperating with China, all Member States, individually and within sub-regional cooperation frameworks, such as the 16+1 format, have a responsibility to ensure consistency with EU law, rules and policies.”

We will now turn to issues of regulatory convergence from a multilateral, regional and bilateral perspective.

## 4. Increasing regulatory convergence?

### 4.1 Multilateral dispute settlement

A major grievance, not just on the side of the EU but among other BRI addressees as well, concerns dispute settlement. Given the all-encompassing and colossal scale of the BRI projects and the understandable logic of streamlining proceedings and cost effectiveness, in January 2018 the Supreme People’s Court in China announced the setup of a dispute settlement mechanism dedicated to handle litigations that may arise from the 86 countries that the BRI currently involves. In fact, the Supreme People’s Court announced that three international commercial courts would be established to handle disputes related to projects under the BRI: one in Beijing (as headquarters), another in Shenzhen (for disputes arising on the Maritime Silk Road) and a third in Xi’an (for disputes along the Silk Road Economic Belt). In addition, the China Council for the Promotion of International Trade (CCPIT) was set up to establish a ‘Belt and Road

International Dispute Management' Centre (in Shenzhen) which will assist arbitration centres like the one already set up in the Qianhai district.<sup>58</sup>

However, going by the international canons on conflict of laws and the territoriality-based choice of law rules, courts normally respect the freedom of contractual parties to choose the law of the forum when determining the applicable law at times of dispute. Chinese law prescribes that, where parties to an international contract fail to select the applicable law, the contract will be governed by the law of the state that has the closest link to it.<sup>59</sup> In the case of disputes regarding BRI-funded projects, Chinese legal logic prescribes that to be China.<sup>60</sup> To other jurisdictions, however, if a dispute arises and where investment protection is governed by those states' laws, that tort should fall under Chinese jurisdiction may be devoid of logic. Under the present blueprint of the BRI's legal architecture, a lending or any other kind of commercial agreement concluded between China and another country will opt for Chinese jurisdiction as the law of the forum in the event of dispute.<sup>61</sup>

***If, as its leadership proclaims, China is committed to upholding and modernising the multilateral trade system, it should mobilise the broad international buy-in for its connectivity and growth strategy to fit the BRI with a legal architecture and dispute settlement mechanism that spurs international solutions rather than imposes Chinese legal constructs.***

If, as its leadership proclaims, China is committed to uphold and modernise the multilateral trade system,<sup>62</sup> then it should mobilise the broad international buy-in for its connectivity and growth strategy to fit the BRI with a legal architecture and dispute settlement mechanism that spurs international solutions rather than imposes Chinese legal constructs.<sup>63</sup> Given the magnitude of EU-China trade and investment links, the Union has stressed the importance of developing a more balanced and reciprocal economic relationship by working together with China in international

<sup>58</sup> See M. Erie, "The China International Commercial Court: Prospects for Dispute Resolution for the 'Belt and Road Initiative'", *ASIL Insights*, Vol. 22, Issue 11, 31 August 2018.

<sup>59</sup> Cf. articles 4 and 6 of the Law on the Laws Applicable to Foreign-related Civil Relations, as well as Article 126 of the Chinese Contract Law and Article 145 of the General Principle of Civil Law.

<sup>60</sup> For a special series of BRI-relevant judgments rendered by Chinese courts, see the website of the 'Guiding Chinese Cases' project of Stanford Law School, available at <https://cgclaw.stanford.edu/>.

<sup>61</sup> Recognising and enforcing foreign judgment in China is a difficult undertaking, treacherous and cost-consuming. See W. Zhang, *Recognition and Enforcement of Foreign Judgments in China: Rules, Practices and Strategies*, Kluwer Law International, 2014.

<sup>62</sup> See, e.g., Z. Ming, "China supports and upholds multilateral trading system", *EU Observer*, 26 July 2018.

<sup>63</sup> In order to achieve a swift, less costly, dispute settlement solution, one may not be inclined to seek investor-to-state dispute settlement (ISDS) as a solution. In recent years, UNCITRAL has identified a few concerns with the mechanism, such as consistency, coherence, predictability, correctness of arbitral decisions, cost and duration, which require improvement. Other concerns pertain to arbitrators and decision-makers, cost and duration of ISDS cases. For details, see "Possible Reform of Investor-State Dispute Settlement (ISDS)", note by the Secretariat, United Nations Commission on International Trade Law Working Group III, Thirty-sixth session, Vienna, 29 October – 2 November 2018, A/CN.9/WG.III/WP.149.

fora to upgrade the rules.<sup>64</sup> Whereas the EU's new Strategic Outlook on China focuses on the WTO, one could easily include the BRI as well.

## 4.2 '16+1' countries

The regions of Central, Eastern and South-Eastern Europe are covered by distinct policies of the EU. Central Europe is all about the EU's big enlargement of 2004, and the role of the now not-so-new member states. Eastern Europe for the EU is about the six Eastern Partnership states, of which three (Georgia, Moldova and Ukraine) have concluded ambitious Association Agreements and Deep and Comprehensive Free Trade Areas (DCFTAs) with the EU. The region of South-Eastern Europe refers here to the pre-accession countries of the Western Balkans. Bulgaria and Romania joined the 2007, Croatia in 2013.

The point of looking at these regions together is that they are all committed to applying or approximating EU regulations and standards,<sup>65</sup> while China for its part has developed an ambitious multilateral initiative with 16 of these states, dubbed the '16+1' initiative, into which projects under the BRI can fit. The 16 states are the three Baltic member states, the four Visegrad member states (Czechia, Hungary, Poland, Slovakia), four South-Eastern member states (Slovenia, Croatia, Bulgaria, Romania), and five non-EU Balkan states (Albania, Bosnia-Herzegovina, North Macedonia, Montenegro, Serbia); thus 11 out of the 28 EU member states plus the five non-members, but without the Eastern Partnership states. Should this unorthodox multilateral forum be of concern to the EU? It has actually raised two kinds of concern.

The first concern is strictly economic, about matters of level (or uneven) playing fields in sectors relevant for BRI funding, notably in the construction and infrastructure sectors. As noted above, there are serious issues of competition, state aid and government procurement policies, and of the related role of Chinese state-owned enterprises that are of concern both within the EU and in regard to non-EU states that are approximating EU laws.

The second concern, perceived but until recently less visible in official European diplomatic exchanges, is of a more geopolitical character, where China applies 'divide and rule' tactics to develop economic clientele relationships with member and neighbouring states at the expense of common EU policies agreed in Brussels. Within the EU, Hungary (Box 10) is often referred to for breaking the consensual EU approach towards the BRI. This is not to say that other member states never lent a helping hand to Beijing, for instance to prevent it from being rapped over the knuckles for its poor track record on human rights<sup>66</sup> and territorial claims in the South China Sea,<sup>67</sup> and for promoting its market

*China applies 'divide and rule' tactics to develop economic clientele relationships with member and neighbouring states at the expense of common EU policies.*

<sup>64</sup> JOIN(2019) 5 final, 12 March 2019, at 6.

<sup>65</sup> Except for the three non-DCFTA Eastern Partnership states, Belarus, Armenia and Azerbaijan, although Armenia's new agreement with the EU contains a limited amount of approximation to the EU's acquis.

<sup>66</sup> See "Greece blocks EU's criticism at UN of China's human rights record", *The Guardian*, 18 June 2017.

<sup>67</sup> See "EU's statement on South China Sea reflects divisions", *Reuters*, 15 July 2016.

economy status.<sup>68</sup> Bigger member states like Italy and richer ones like France and Germany have exhibited similar behaviour.<sup>69</sup> But the sub-regional ‘16+1’ structure remains unique.

*Box 10. Hungary as China’s ‘Trojan horse’ in the EU?*

On 14 May 2017, at the maiden Belt and Road summit in Beijing, the EU refused to sign the final communiqué. But Hungary later broke ranks and did sign the document. In April 2018, 27 out of 28 EU member state ambassadors in Beijing, with Hungary again the exception, reiterated that stance when they signed a document denouncing the BRI for hampering free trade and giving an advantage to Chinese companies. The document, which was prepared with a view to the Sino-EU Summit of 25 June 2018 and leaked to the German newspaper *Handelsblatt*, said that China was attempting to shape globalisation to suit its own interests and that the Belt and Road Initiative was “pursuing domestic political goals like the reduction of surplus capacity, the creation of new export markets and safeguarding access to raw materials”.<sup>70</sup> The document, which was never formally released, further stated that the BRI “runs counter to the EU agenda for liberalising trade and pushes the balance of power in favour of subsidised Chinese companies”. The report cautioned that European companies might not secure good contracts if China was not compelled to the EU principles of transparency in public procurement, as well as environmental and social standards.<sup>71</sup>

In the context of the Union and its neighbourhoods, the EU institutions should be concerned about the 16+1 process acquiring such substance and momentum that could undermine the setting of EU policies that sought to be protective of its own interests, values and law.

In terms of trade between China and the 16 CEEC countries, in 2017 trade in goods between the 16 and China amounted to €57.3 billion, a small amount compared to the total EU-China trade of €573 billion and falling short of the initial aim to reach US\$100 billion by 2015. Each of

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<sup>68</sup> See “It is in Hungary’s interests for China to be afforded market economy status”, Ministry of Foreign Affairs and Trade, Hungary, 9 June 2016 (<http://www.kormany.hu/en/ministry-of-foreign-affairs-and-trade/news/it-is-in-hungary-s-interests-for-china-to-be-afforded-market-economy-status>).

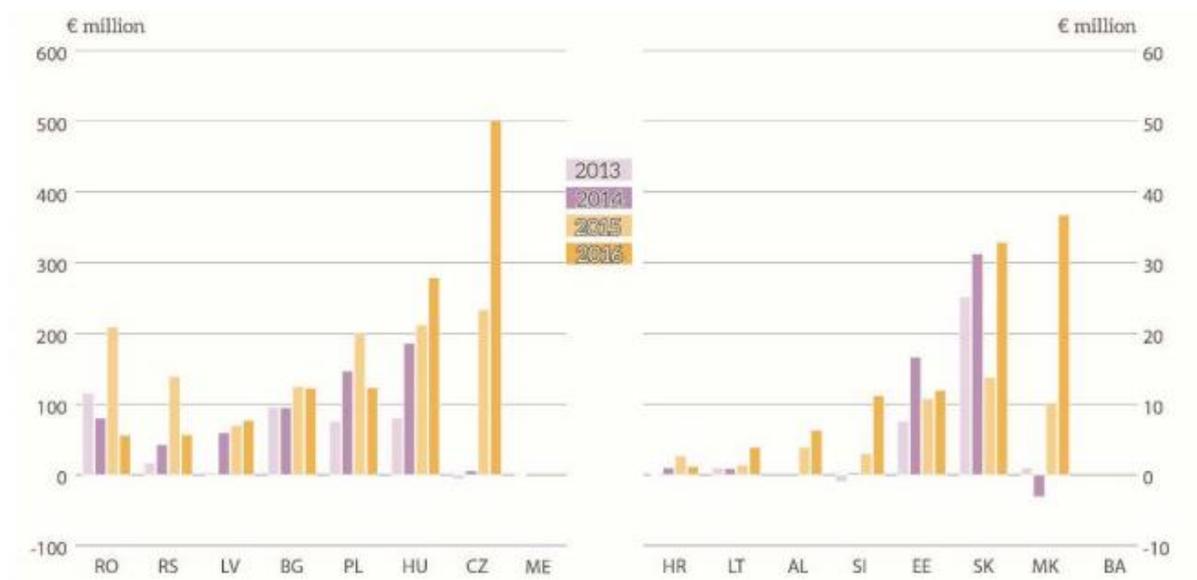
<sup>69</sup> D. Ghiglione et al., “Italy set to formally endorse China’s Belt and Road Initiative”, *Financial Times*, 6 March 2019. If and when the fractious governing coalition in Rome signs a memorandum of understanding with China in support of Beijing’s Belt and Road Initiative, it would make Italy the 14<sup>th</sup> EU member state to do so. In the history of EU-China relations, there are other occasions when member states bowed to the imperial ‘divide and rule’, too, often to secure their respective commercial interests with China. For example, in 1997, France, Germany, Spain and Italy refused to endorse an EU resolution condemning China’s human rights record for submitting to the UN Commission on Human Rights. As a result, Denmark took the initiative and drafted it without EU support. China retaliated against Denmark for the resolution and the Netherlands, holder of the EU Presidency, for making a China-critical speech at the UNCHR and trying to draft the EU-wide resolution. Between 1989 and 1996, the EU had sponsored such a resolution annually. See “Political values in Europe-China relations”, ETNC Report, at 17, 59.

<sup>70</sup> See “EU ambassadors band together against Silk Road”, *Handelsblatt*, 17 April 2018.

<sup>71</sup> A spokesman of the Chinese Foreign Ministry later said that the EU had clarified the issue and that the *Handelsblatt* report about the ambassadors’ document was inaccurate. See “EU presents (nearly) united front against China’s ‘unfair’ Belt and Road Initiative”, *South China Morning Post*, 20 April 2018.

the 16 run a trade deficit with China. Poland is by far the biggest trading partner with China, followed by the Czech Republic and Hungary. China's FDI stock in the 16 is fairly low and also shows a strong geographical concentration in the bigger EU-11. Serbia is the only Western Balkan country to have attracted sizeable FDI from China.

Figure 7. China's FDI stock in the CEECs, 2013-2016



Source: G. Grieger, "China, the 16+1 format and the EU", EPRS, September 2018, using Eurostat data.

The controversial aspects of the BRI in general, especially in Asia and Africa, are its debt-financing of huge projects that are not subject to the normal governance standards of the classic international financial institutions (World Bank, EBRD). Such projects were, initially at least, accepted with some alacrity by countries with corrupt authoritarian regimes. There are already signs of push-back against such experiences (Malaysia, Sri Lanka). The concluding declaration of the fifth annual 16+1 summit meeting, hosted by Bulgaria in Sofia in July 2018, showed some diplomatic sensitivity to these concerns, with the first page of text stressing how the 16+1 activities would be fully respectful of EU laws and policies.<sup>72</sup> The text went on a further 15 pages to describe how the 16+1 would be working to a comprehensive agenda, coinciding with many EU competences. In addition, the EU is now invited to join these summit meetings as an observer. But these are just diplomatic gestures, while the 16+1 process goes full steam ahead and the next meeting is scheduled to take place immediately after the 21<sup>st</sup> EU-China Summit in April 2019.

The East European states, outside the 16+1, introduce other issues. Of special interest is the role of Georgia, which has followed up on its DCFTA with the EU with a more limited classic free

<sup>72</sup> Sofia Guidelines for Cooperation between China and Central and Eastern European Countries, 9 July 2018, available at [https://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/2649\\_665393/t1577455.shtml](https://www.fmprc.gov.cn/mfa_eng/wjdt_665385/2649_665393/t1577455.shtml).

trade agreement with China. Georgia also seeks to play a transport hub role in connecting Europe and Asia with a route that offers an alternative to the northern route through Russia. The idea of having free trade with both the EU and China relates to the historic role of the Silk Road of past centuries, when Central Asian states and Iran were significant economic powers that were not just transit passages, but also locations for value-adding industry for the products that moved along the old Silk Road.<sup>73</sup> The EU for its part wishes Georgia and the other DCFTA states to succeed in their economic modernisation and development. If there turns out to be positive synergies here between the EU and BRI policies, then that is to be welcomed. The EU is also interested in preventing the BRI from becoming a Russian transit monopoly for land trade between itself and China. In this respect geopolitical considerations become a more complex trilateral affair involving the EU, China and Russia.

When examining the 16+1 cooperation in light of the BRI, the former provides a convenient vehicle for China to venture into the territories of the 16 CEECs. Nonetheless, this risks disrupting the Union's strategy towards China as a whole. At the same time, as China's BRI investment in infrastructure and energy often entails bad practices incompatible with EU's rules and norms, it is enough to say that China's 16+1 cooperation initiative is something of an irritant in the eyes of the EU. Then again, those bad practices are often a consequence of easy money that tarnish the good reputation that China wishes for its global competitiveness strategy.

As mentioned above (section 4.1), another grievance against the lending practice of China's billion-euro loans granted to CEECs is the choice of law at times of dispute.<sup>74</sup> Presently, China's investment along the BRI is largely facilitated by intergovernmental on-lending agreements concluded between policy banks, such as those between the China Development Bank and the Hungarian Development Bank. As the terms of such agreements are often kept confidential, it seems that disputes will fall under Chinese jurisdiction, as is the case of Kostolac B in Serbia.

*Box 11. Kostolac B3 power plant in Serbia*

The construction of the 350 MW lignite power plant, Kostolac B3, by the Serbian state-owned utility Elektroprivreda Srbije (EPS) near Pozarevac is the second phase of a project implemented by the China Machinery Engineering Corporation (CMEC) and financed by the China EximBank. In the first place, in November 2013, the Serbian government signed an agreement with CMEC for the construction of Kostolac B3, and no tender procedure took place. Instead, the Chinese and Serbian governments signed an intergovernmental agreement freeing joint projects from tender obligations. Second, the Serbian government and the China EximBank in December 2014 signed a loan agreement worth \$608 million (€537 million) for Kostolac B3 and expansion of the Drmno open-cast lignite mine. On 19 January 2015, the Serbian parliament voted on the loan

<sup>73</sup> See P. Frankopan, *The Silk Roads – A New History of the World*, London: Bloomsbury, 2015.

<sup>74</sup> See G. Grieger, "China, the 16+1 format and the EU", European Parliamentary Research Service, September 2018.

ratification in an extraordinary session announced to the public less than 24 hours in advance. It includes, among others, the stipulation that any arbitration would be carried out in Beijing.<sup>75</sup>

All in all, the 16+1 cooperation appears to be a convenient vehicle for the BRI to venture into Central and Eastern Europe. The multimillion-euro question that (aspirant) countries of the EU should ask themselves is whether their affiliation to China's way of doing business risks compromising their duty of sincere cooperation with the EU (still the biggest investor) and adherence to its *acquis* (Article 4(3) TEU).

### 4.3 EU-China bilateral relations

In an effort to circle the wagons as Beijing makes political and economic inroads into the wider European regulatory space, the European Commission and the High Representative pushed the member states into endorsing a consistent posture to deepen cooperation with China on trade and investment while dealing with strategic and security tensions around Chinese technology.<sup>76</sup> The EU also wants to seal an ambitious Comprehensive Agreement on Investment (CAI) with China by 2020. It is expected that language to that effect will be included in the joint communiqué of the 21<sup>st</sup> EU-China Summit on 9 April 2019.

The EU ambition for a 2020 deadline for the bilateral investment agreement reveals a new level of activism in bilateral ties, after painfully slow progress during 19 rounds of negotiations that took place between 2013 and 2018.<sup>77</sup> After the 19th round of negotiations (Beijing, 29-30 November 2018), it was reported that for the first time both parties provided their formal feedback on the market access offers exchanged in the margins of the 20th EU-China Summit in 2018.<sup>78</sup> Progress was made in particular on investment protection-related provisions such as expropriation and compensation for losses. On state-to-state and investor-to-state dispute settlement additional technical follow up was required. For fair and equitable treatment as well as on national treatment and its related provisions and exceptions, still further substantial follow up was needed, together with discussions on transfers and capital movement provisions, which remains at an initial stage. On sustainable development, parties are said to move closer on their understanding of investment-related aspects of environment and labour.

*The EU ambition for a 2020 deadline for the bilateral investment agreement reveals a new level of activism in bilateral ties.*

<sup>75</sup> See Kostolac, "B3 lignite power plant, Serbia", *BankWatch Network* (<https://bankwatch.org/project/kostolac-lignite-power-plant-serbia#project-background>).

<sup>76</sup> See JOIN(2019) 5 final, 12 March 2019, as welcomed by the Foreign Affairs Council of 18 March and discussed by the European Council on 22 March 2019.

<sup>77</sup> An EU-China FTA is still a pipedream. See J. Pelkmans, W. Hu et al., *Tomorrow's Silk Road: Assessing an EU-China Free Trade Agreement* (2nd Edition), Rowman & Littlefield International, 2018.

<sup>78</sup> See Report of the 19th round of negotiations for the EU-China Investment Agreement, European Commission, Directorate-General for Trade, Trade B2, Brussels, 13 November 2018.

Buoyed by a stable economy, China had already committed to remove ownership caps in certain financial services sectors by 2021 and on car manufacturing by 2022. The decision of the NRDC in July 2018 to shorten its ‘negative list’ by easing or scrapping foreign ownership limits on surveying and mapping, power grids, shipbuilding and aircraft manufacturing,<sup>79</sup> was intended to woo European investors at a time when US tariffs on Chinese imports came into effect. China’s plans will sound like music to the ears of European politicians and business leaders, but deliverables are required to convince the European Commission that China is serious about following up on all of its intentions. In negotiations on a revised Government Procurement Agreement (GPA) in the context of the WTO, the European Commission has advocated an ambitious opening of international public procurement markets.<sup>80</sup> Since December 2007, China has submitted six offers for negotiating to accede to the GPA. In its last offer, submitted in December 2014, China made considerable concessions with regard to, among others, covered entities, activities and thresholds; the grace period for implementing the Agreement was also proposed to reduce from five to three years.<sup>81</sup> Nonetheless, the sixth offer did not meet the expectations of the GPA members. Further negotiations are ongoing.<sup>82</sup>

***Once the IPI is implemented, it may help to guarantee reciprocity of access to public procurement markets in the EU and China by European and Chinese businesses.***

In the meantime, in January 2016, the Commission adopted an amended proposal for International Procurement Instrument (IPI), a regulation ‘on the access of third-country goods and services to the Union’s internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries’.<sup>83</sup> Once the IPI is implemented, it may help to guarantee reciprocity of access to public procurement markets in the EU and China by European and Chinese businesses. However, the file seems to be stuck in the legislative process and is unlikely to be adopted any time soon. An EP resolution adopted in September 2018 calls on the Council to swiftly adopt the IPI, and to be vigilant and take action against contracts awarded to foreign enterprises suspected of dumping practices. One of the ten action points

<sup>79</sup> See L. Hornby, “China loosens investment curbs as trade war looms”, *Financial Times*, 30 June/1 July 2018.

<sup>80</sup> Available at [https://ec.europa.eu/growth/single-market/public-procurement\\_en](https://ec.europa.eu/growth/single-market/public-procurement_en).

<sup>81</sup> With regard to the grace period for implementing the GAP, China requested 15 years in its initial offer, then reduced it to 5 years in its 4th offer. For an analysis of the trends of China’s six GPA offers, see J. Pelkmans, W. Hu et al., *Tomorrow’s Silk Road: Assessing an EU-China Free Trade Agreement* (2nd Edition), Rowman & Littlefield International, 2018, at 159-160.

<sup>82</sup> At the 7<sup>th</sup> annual EU-China High-level Economic and Trade Dialogue (HED), China confirmed its commitment to acceding to the GPA. The EU sought assurances from China that it would negotiate its accession to the GPA on the basis of an ambitious and comprehensive offer. See “EU and China discuss economic and trade relations at the 7<sup>th</sup> High-level Economic and Trade Dialogue”, Press release, European Commission, Brussels, 25 June 2018. Additionally, China committed to expedite the process of its accession. See “Joint statement of the 20<sup>th</sup> EU-China Summit”, at para 17.

<sup>83</sup> Amended proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union’s internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries, COM (2016) 34 final, Brussels, 29 January 2016.

issued by the Commission and High Representative in their Strategic Outlook document of 12 March 2019 urges the Parliament and the Council to adopt the IPI before the end of 2019.<sup>84</sup>

Amid worries that US President Trump might withdraw the US from the World Trade Organization (a move that would require US Congressional support), the EU-China Summit of 16 July 2018 concluded with an agreement to set up a joint working group for concrete cooperation on WTO modernisation in key areas relevant for the global level playing field, such as industrial subsidies. For the EU, this joint working group serves as an additional instrument to exert pressure on China to align its trade practice with the WTO principle of national treatment and to accede to the GPA in an expeditious manner.<sup>85</sup>

## 5. Concluding remarks

Chinese policymakers like to brand the BRI as a “win-win cooperation”. There is, however, a marked disconnect between that rhetoric, the realities on the ground, and increasingly negative perceptions in the EU about this cooperation. Europeans are waking up to the fact that all roads no longer lead to Rome but to Beijing, and that they are lagging behind China and the US in preparing for the 4<sup>th</sup> industrial revolution – an international economy based on telecommunications infrastructure, artificial intelligence and space technologies.<sup>86</sup> Member state governments have been responding to aggressive overtures from China towards their economies to protect their strategic sectors. But in spite of the 2018 EU Strategy on Connecting Europe and Asia, Europe’s response overall has been rather incoherent. The strategic course correction of March 2019 aims to change this.

Our own empirical research has exposed the need to plug the gaps in the intersection between EU competition law, rules on state aid and public procurement, and the regulatory patchwork of member states’ FDI review mechanisms. In the political sphere, member states would do better to coordinate their actions at 27/28 and to prevent the Union from falling prey to the imperial doctrine of ‘divide and rule’. Even if its relative global weight is waning, the European Union is still the world’s largest economic collective and a regulatory powerhouse to be reckoned with. Existing EU legislation (for example on public procurement) already has a deterrent effect on malpractices (cf. delayed investments, derailed proposals) and the new EU-level FDI screening mechanism will help to reinforce these legal defences.

Nevertheless, Europe must not fall into the trap of protectionism. It should not ignore the fact that, over the past four decades, China has accrued considerable economic strength and know-how. Beijing can be a constructive partner, especially in view of an unpredictable trading partner across the Atlantic. The EU needs to perform a delicate balancing act to convince China

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<sup>84</sup> See JOIN(2019) 5 final, 12 March 2019, at 7.

<sup>85</sup> See “EU and China discuss economic and trade relations at the 7<sup>th</sup> High-level Economic and Trade Dialogue”, Press release, European Commission, Brussels, 25 June 2018.

<sup>86</sup> See A. Renda, “Digital Economy, Industry and Innovation”, in S. Blockmans (ed.), *What Comes After the Last Chance Commission? Policy Priorities for 2019-2024*, CEPS, Brussels, 2019, at 92.

of the need for a level playing field and to turn the Belt and Road Initiative into a two-way street for economic growth. This is not only in Western Europe's interest – the main trading and investment destination for China – but also in that of the 16 countries of Central and Eastern Europe, as well as the Caucasian and Central Asian countries along the new Silk Road. Reciprocal benefits rather than mutual harm.

The assertiveness expressed by the EU's new Strategic Outlook on China should alert policymakers in Beijing to the fact that Europe's common legal defences will bar Chinese investors from the single market if, in spite of a change of official rhetoric in favour of free and fair trade two years ago, the BRI continues to lack inclusiveness, fails to invite foreign participants, and does not observe best practices of commercial and legal governance. For the sake of the BRI's success and mutual economic benefit, Chinese policymakers would be well advised to address European concerns in a fair-minded and constructive manner, rather than stonewall the EU with ever-louder empty messages that the Belt and Road Initiative is a panacea for all.