



Università
Ca'Foscari
Venezia

Master's Degree programme in
Language and Management to China
“ordinamento” ex D.M. 270/2004

Final Thesis

Chinese Foreign Direct Investment in the European Union: critical analysis of a process in the making

Supervisor

Ch. Prof. Andrea Pontiggia

Assistant supervisor

Ch. Prof.

Graduand

Alessandro Di Gregorio

Matricola 885321

Academic Year

2021 / 2022

前言

在现今的经济格局中，企业的国际扩张已经成为一个必要的局势，而企业可从事跨国经济活动的方法之一，就是透过外商直接投资，即FDI。

这种国际化模式是本论文所要讨论的主题，旨在深入探讨这些来自中国外商直接投资的优点，以及中国企业在全球投资领域所展露的头角。

本论文共分为四章：第一章为概论，阐释论文主题，并聚焦在对FDI现象提出理论解释的邓宁国际生产折衷论。此生产折衷论确立企业决定到国外投资的主因，亦即获得特定的资源，得以进入某特定市场，并享受因不同国家其不同生产条件所带来的利润，以及获取可提高企业全球竞争力的资产。

正如第二章所分析的，中国从一个被已开发国家的外商直接投资对象，特别在最近几年，已跃然成为全球主要的外商直接投资国，在已开发及开发中国家进行投资。

不仅如此，中国对外直接投资在很长一段时间内几乎是恒定成长。尤其是从2001年中国加入世界贸易组织（WTO）开始，直到2016年中国经济政策转向为对外投资为止。中国对外直接投资案例具有特殊性，其特殊性与投资企业、动机、因素、对象和管道有关。此外在第二章中，特别观察中国经济在政府目标导向下，其经济政策措施的推出及改变如何影响企业走向，不仅如此也影响对外直接投资的程度。因此可以观察到政府是如何决定和引导绝大部分的中国外商直接投资。

紧接着，本论文的重点聚焦在对欧洲背景的深入分析。事实上，第三章通盘讨论中国在欧盟各国从过去到现今所做的FDI。此外也分析从此世纪初到现今，大量中国FDI在欧陆各国进行的理论依据和原因。

中国经济的独特性，加上其“后来者”地位，使得研究中国企业能在欧盟这样一个高度复杂且多样性的环境中运作的原因极具特色。此外，将讨论单一产业的重要战略性，及位处所在国的高品质特性，是中国跨国公司寻求投资的关键因素。

在第三章结尾假设性地分析在纯粹宏观经济层面上，可能影响中国外商在欧洲直接投资的因素。无论相关国家的个别政治立场为何，实际上，近几年事实证明，中美两大强国不稳定的双边关系，因着两方政治高层持续未知的变化，反映出对此议题呈现混乱不明的公众舆论。

本论文终章第四章，将仔细研究对塑造中欧未来关系具有高度经济性和战略性的挑

战计划，即 "一带一路 "措施、"中欧全面投资协定"，以及中国的 "中国制造2025 "和欧洲的 "工业4.0 "计划的结合。这些计划的实施，即使目前仍尚为实现，将对两方甚至全球产生决定性的影响。

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Introduction

In today's economic landscape, the international expansion of firms has become a phenomenon of important dimensions, and one of the methods in which they can engage in activities beyond national borders is through foreign direct investment, or FDI.

This mode of internationalization is the subject of this paper, which through the analysis of the most important theories and studies developed on the subject, aims to go into the merits of FDI from China and the emergence of firms from this country in the global investment landscape.

In order to do so, this paper is divided into four chapters: considering the fact that the first companies to become interested in FDI were those from developed countries, the first Chapter provides a general overview of the topic starting with some definitions and then focusing on the theoretical apparatus that has tried to give an explanation to the phenomenon of FDI and that refers to Dunning's eclectic paradigm. The latter, moreover, has identified the main reasons why a firm decides to engage in foreign activities, namely, to obtain particular resources, to gain access to certain markets, to enjoy the different endowments of factors of production in different countries, and to obtain assets that increase the firm's global competitiveness. Different aspects of the topic are then considered, such as the various factors or determinants behind foreign direct investment location decisions and the effects that FDI and the activities of MNEs have in the economies of the home and host countries.

This is the context of the experience of China, which represents a large emerging economy that has seen continuous growth for about twenty years.

As analyzed in Chapter Two, this country from a large receptacle of FDI, mainly from developed countries, has become, especially in recent years, a major source of FDI globally, making investments in developed and undeveloped countries.

In particular, the increase in Chinese outbound FDI for long time has been almost constant, especially from 2001, when China joined the World Trade Organization (WTO), until 2016, when a sudden change in China's political will to largely invest abroad happened. The case of outbound FDI from this country has special features related to the profile of investing firms, motivations, determinants, investment destinations, and mode of entry into the host country, for which most theories advanced for FDI from developed countries are not adequate.

However, given that one of the most important features of the international expansion of Chinese firms points to the influence exerted on them by the government, that is, the interference of the Chinese political environment on the economic environment, it seems that institutional theory comes closest to providing an adequate explanation of the emergence and development of Chinese outbound FDI in the international economic landscape.

Thus, in Chapter Two, it is observed how the launching of initiatives and policies and changes in China's economic environment, dictated by the government's objectives, can influence the behavior of firms and thus the extent of outbound FDI in the country. We can thus observe how the government can determine and guide much of the FDI from China.

Subsequently, the focus of this paper narrows toward a more in-depth analysis of the European context. Indeed, in Chapter Three, a thorough mapping of the past and recent presence of Chinese FDI in the various countries of the European Union is carried out. The main theories and reasons why, from the early years of the new century until the recent past, a large amount of Chinese FDI has been made in various states of the Old Continent are also analyzed.

The unique characteristics of their home economy, combined with their "latecomer" status, make it particularly interesting to study the reasons behind the operations of Chinese companies in such a highly complex and diverse environment as the European Union. In this chapter we will observe how the strategic importance of the single industry of belonging, as well as its high quality in a given country, are key elements in the pursuit of investment by multinationals from the People's Republic. In fact, these kinds of highly targeted investments are key to closing, or at least shortening, the technological and managerial gap that still separates Chinese and European high-strategic impact industries. In support of this thesis, a case study is presented regarding the acquisition of Swedish car maker Volvo by Geely, former refrigerator manufacturer that in less than 20 years has managed to climb the ranks of Chinese sedan manufacturers.

Chapter Three concludes with a hypothetical analysis of the possible factors that may influence on a purely macroeconomic level the variation of Chinese foreign direct investment in Europe over time. Regardless of the individual political positions of the countries involved, in fact, it now seems clear that, especially in recent years, bilateral relations between the two powers are highly unstable and at the mercy of continuous and unpredictable changes of mood on the part of the political classes, mirroring a rather confused and undecided public opinion on the subject. The advent of the pandemic crisis and the following armed conflict in Ukraine have only exacerbated an already highly volatile situation, made so, as we shall see, by a combination of ideological, political and economic factors and motivations involving both the European Union and China, but also another "interested observer", the United States of America.

The paper concludes with Chapter Four, where the main challenges and opportunities that are projected to be of high economic and strategic interest in shaping the future relationship between China and Europe are scrutinized, namely the "One Belt, One Road" initiative, the "Comprehensive Agreement on Investment", and the combination of China's "Made in China 2025" plan and Europe's "Industry 4.0". The eventual implementation of these plans, however far from realization at the

moment, would have decisive consequences not only for the parties involved, but globally. As we shall see, if the first two proposals can be defined as bringing the two powers closer together economically, the "Made in China 2025" plan and the abrupt change in economic and social ideology underlying it could, on the other hand, decrease the amount of mutual foreign direct investment, a process that, on closer inspection, has already begun. In fact, as much as the "One Belt, One Road" initiative and the "Comprehensive Agreement on Investment" imply, both in terms of infrastructure and binding legislative apparatus, the concrete realization of an increasingly close and strong link between Europe and Asia, these two clash with Beijing's new policies, which are increasingly focused on the development of a quality domestic market and a consequent closer control over outbound foreign direct investment.

Finally, as in part mentioned above, a brief but necessary premise to this paper is related to the current process of global decoupling that began well before the outbreak of the Covid-19 pandemic and the Ukraine-Russia war, but is nonetheless gaining strength, partly and especially because of these events. The rapid development of these happenings has, in a very short time, made the discussion of the aforementioned issues somewhat anachronistic. Suffice it to say that the first ratification of the "Comprehensive Agreement on Investment," as mentioned at the moment frozen, is dated December 30th, 2020. It is therefore almost impossible, as of today, to hazard any concrete assumptions about the progress of the latter and the other pending initiatives.

CHAPTER 1

Foreign Direct Investments

1.1 Foreign Direct Investment: theoretical concepts

Business internationalization is achieved through three modes of implementation: exports, collaborative agreements and foreign direct investment or FDI. Specifically, following the definitions provided by the International Monetary Fund or IMF (in the *Balance of Payments and International Investment Position Manual: Sixth Edition*, Washington, D.C., 2009) and the Organization for Economic Co-operation and Development or OECD (in the *OECD Benchmark Definition of Foreign Direct Investment-Fourth Edition*, Paris, 2008) an FDI is an investment in a foreign enterprise (direct investment enterprise) in which the foreign investor (direct investor) owns at least 10 percent of the common stock or voting power, which has the objective of establishing a lasting interest in the country, a long-term relationship and significant influence in the management of the enterprise.

FDI involves a transfer of a package of intermediate assets or products, including financial capital, organizational and management expertise, technology, entrepreneurship, incentive structures, cultural values and norms, and access to foreign markets. Furthermore, FDI does not involve changes in ownership: decision-making power over the use of the transferred resources remains with the investing party. In this sense, FDI differs from portfolio investment, which, by contrast, involves only the transfer of financial capital and does not imply significant influence in the management of the enterprise (Dunning, Lundan 2008).

The one who makes an FDI, the foreign investor, is identified in individuals or groups of individuals, enterprises or groups of public and private enterprises, and governments that have acquired at least 10 percent of the voting power of a corporation, or the equivalent for an unincorporated enterprise residing in another economy. This enterprise is defined as a direct- investment enterprise, which is also referred to as a foreign affiliate, either in the form of a corporation such as a subsidiary (where the investor controls more than 50 percent of the voting power) and an affiliate (where the investor controls at least 10 percent but not more than 50 percent of the voting power), or in the form of an unincorporated enterprise.

The creation of subsidiaries in a foreign country can be done mainly through two ways: *greenfield* FDI, which is when investment projects involving the creation of entirely new facilities are carried out, or the process of mergers and acquisitions (M&A: *Mergers and Acquisitions*) of pre-existing

companies, which has seen substantial growth in recent years (UNCTAD 2015). M&A transactions are generally motivated by the desire to achieve greater efficiency and better profits and directed toward markets more competitive where it is difficult to penetrate through different modes.

Greenfield investments, on the other hand, are directed toward less competitive markets and often in developing countries (Bertrand 2004).

These two different methods of entry into the foreign country have different effects in the foreign country's economy, in that, generally, the M&A form does not result in significant changes in the performance of economic activities such as output, employment, and turnover, unless a significant restructuring of the acquired firm is to be carried out. *Greenfield* investments, on the other hand, add new dimensions to the economic performance of the host country, such as job creation, and to the earnings of those who invest.

Measures of foreign direct investment are FDI flows, which include capital stock, reinvested earnings and other direct capital investment, and the stock of FDI, which, on the other hand, represents the total direct capital owned by non-residents in a given country in any given year (Barba Navaretti, Venables 2006).

To offer a general overview of the topic, we must distinguish between the two different types of foreign direct investment, namely horizontal FDI and vertical FDI. Following the view of Shatz and Venables (2000) two main motivations are identified for why a firm decides to go international: to better serve a local market and to obtain low-cost inputs. The first motivation underlies horizontal FDI, while the second is fulfilled by vertical FDI.

In order to serve a foreign market, the enterprise may decide to carry out horizontal FDI, specifically a stage of the production process is duplicated by setting up a foreign plant in addition to the plant already present in the home country. The shift to local production will result in benefits such as reduced costs related to supplying markets, such as transportation costs and tariffs, and consolidation of the firm's competitive position due to its proximity to the market and ability to respond to changes in local circumstances and preferences.

Horizontal FDI tends to substitute for exports in cases where market access costs are high or costs related to establishing a local plant are low. In addition, the same substitution occurs in cases where markets are large, for two reasons: the fixed costs of the plant can be spread over several units of product, and the presence of numerous local firms, and thus greater competition, leads to lower product prices, so if the marginal cost of supplying the market through exports is high, a firm will consider it more cost-effective to move production locally.

Vertical FDI, on the other hand, refers to moving entire stages of the vertical production chain to countries where inputs such as labor, raw materials, intermediate goods and access to externalities

are cheap. For this type of FDI, one must consider the fact that different stages of the production process may require different inputs, the price of which is different in different countries, so, it may be convenient for the company to divide the production process into different areas. Vertical FDI generally tends to stimulate exports as products, at different stages, are traded between the various locations.

1.2 Determinants of FDI: Dunning's Eclectic paradigm

One of the interpretations that still dominates among economic theories of the determinants of FDI and foreign activities of MNEs is the eclectic paradigm that was first presented in 1976 by Dunning. Initially characterized by microeconomic explanations, it has undergone numerous modifications over the years aimed at introducing a macroeconomic level and an institutional dimension.

The Eclectic paradigm, or OLI (*Ownership-specific advantages, Locational advantages, Internalization advantages*) represents a conceptual framework that seeks to explain the extent and structure of firms' foreign activities, in particular it identifies three conditions that a firm must meet in order to make foreign direct investment: ownership advantages, rental advantages and internalization advantages.

According to Dunning and Lundan (2008), the first condition refers back to *Ownership-specific advantages*: a firm possesses ownership advantages that, as such, are unique and specific compared to firms in other countries and derive from certain intangible assets. These, in turn, generate competitive advantages that enable the firm to make forms of investment in foreign countries. Specifically, Dunning distinguishes this type of advantages into two categories, *Asset-specific advantages* (Oa), which is the possession of particular intangible assets derived from the enterprise's property rights to information and technological know-how (product innovations, production management, marketing and organizational systems, innovative capacity and experience accumulated by the enterprise in marketing and finance). The second category is called *Transaction cost-minimizing advantages* (Ot), which refer to the advantages due to the firm's ability to coordinate numerous activities internationally, such as those resulting from being a firm already established in the market, exclusive or favored access to factors of production, and those resulting from the firm's very international character, such as greater operational flexibility and better knowledge of international markets. Added to these types of advantages is a third, *Institutional assets* (Oi), which are the formal and informal institutions that govern processes within the firm and between the firm and its *stakeholders*, such as codes of conduct, norms and corporate culture, incentive and evaluation systems, *leadership* and diversity management. Specifically, this is a firm-specific incentive structure

that includes rules, norms and incentives that are either generated internally or imposed externally and influence the firm's operations. The composition and extent of this type of benefit is contextual, in that it reflects the macro-institutional apparatus of the country in which an enterprise operates.

The second condition is *Locational advantages*, the competitive advantages possessed by one country over others: consequently, for the firm, given the country's natural and nonnatural endowments that it can use in conjunction with its own competitive advantages, a location in the country itself is more favorable (Dunning 2000). These advantages include resource availability, input cost, international transportation and communication costs, investment incentives, infrastructure, cultural differences, economic system, institutional structure, and legal system.

The third and final condition that must be met is *Internalization advantages*, which is the fact that the enterprise can add value to its ownership advantages by transferring them across national borders within its own organizations, rather than selling them to foreign enterprises. The interaction of these three variables will determine the enterprise's foreign activity. In the eclectic paradigm, moreover, it is argued that the OLI configuration of a given firm and its subsequent behavior are highly dependent on the context, that is, the economic and political situation of the firm's country and those of the country in which it intends to invest, the nature of the firm's activities, its characteristics, and its goals and strategies.

1.2.1 The motivations and types of FDI according to Dunning's theory

Firms carry out foreign direct investment under the impetus of certain motivations that may change over time: many firms initially invest abroad to secure natural resources and access to new markets; later, having consolidated experience in the international arena, they may seek to improve their position in the global market through the achievement of new competitive advantages. Just by analyzing these motivations Dunning identifies four types of FDI: *natural resource seeking*, *market seeking*, *efficiency seeking* and *strategic asset seeking* (Dunning, Lundan 2008).

According to Dunning and Lundan (2008) for the first type of investment, *natural resource seeking*, the motivation lies in making the investing firms more profitable and competitive in markets by gaining privileged access to particular resources. In particular, firms are driven to invest abroad, and especially in developing countries, to acquire specific resources of higher quality and at a lower cost than those in the home country, and the outputs generated by this type of investment tend, for the most part, to be exported to the foreign market, usually to developed countries. These FDIs are aimed at finding low-cost resources of different types, physical and non-physical, such as raw materials and infrastructure, labor, technological capacity, managerial and marketing skills.

For the second type of investment, *market seeking*, firms invest in specific countries to supply markets in these and adjacent areas with goods and services. When high costs are imposed to supply the local market, such as transportation costs and tariffs, or when the market has reached a size that justifies local production, this type of investment is made, thus replacing exporting. *Market seeking* FDI, in addition to the size and growth prospects of the market, is motivated by other factors: suppliers have foreign production facilities, the product needs to be adapted to local market tastes, production and transaction costs are lower, the firm considers it strategically necessary to have a physical presence in markets served by competitors, and above all, the action of the host country government to stimulate this type of investment.

The third type of investment, *efficiency seeking*, generally occurs when, once *resource-based* or *market seeking* investments have been completed, the firm wants to gain benefits from common *governance* and geographic dispersion of activities. The investment is aimed at obtaining benefits from country cost differences of traditional factor endowments, for example, *labor-intensive* activities are located in countries where labor costs are particularly low. There is, in addition, *efficiency seeking* FDI that also takes place in countries with similar economic structures and is mainly influenced by incentive structures, supporting institutions, local competition, the nature of consumer demand and government policies.

For the fourth type of investment, *strategic asset seeking*, the main motivation is the firm's desire to increase its ownership advantages and promote long-term strategic goals, such as improving their global competitiveness and winning new markets, through the acquisition of R&D expertise and specific assets. Recent years have seen an increase in such investments undertaken by emerging economies (Dunning, Lundan 2008).

1.3 The pull factors of FDI

An enterprise's investment location decision is determined by a number of factors that refer to a country's own characteristics and needs and to the firm's own intentions: the firm's knowledge of the host country market thus becomes a crucial factor (Cheng, Chung 2012).

These pull factors include geographic distance, market size, agglomeration effects, input cost, tax incentives, economic and political environment, its stability and openness to trade, among which, some influence all types of FDI, while others have different effects on the various types (Lim 2001). Regarding geographic distance, this is an important determinant in the decision to where to locate an FDI, as it is considered in terms of costs, for example costs related to transportation, in this case, by their very nature, horizontal and market seeking FDI will be stimulated in the presence of high costs,

while vertical and natural resource seeking FDI will be discouraged. Generally, FDI is also positively influenced by geographic proximity, since by reducing uncertainty related to information, transportation and monitoring costs, the multinational firm is not exposed to risk.

The size of the host market, its growth prospects, and real and per capita GDP also turn out to be one of the most relevant factors that the firm considers. A large market size and high GDP growth encourages horizontal and market seeking FDI, while vertical and natural resource seeking FDI are essentially indifferent to this type of factor. Agglomeration effects, since they generate positive externalities in the area concerned and increase firm productivity and profit, are considered to be an important determinant in relation to each type of FDI. The factors contributing to agglomeration effects are essentially the state and development of infrastructure, the degree of industrialization and the size of FDI stocks already present in the host country. Agglomeration economies serve as a clear signal to other foreign firms that a favorable business environment exists.

Input cost, such as low labor cost, has influence particularly on vertical FDI, natural resource seeking and efficiency seeking, and to a lesser extent on horizontal FDI and market seeking.

Tax incentives offered by the host country have positive effects on all types of investment, especially on vertical FDI, natural resource seeking and efficiency seeking since they are more cost sensitive. To attract FDI, a country may offer special measures and investment tax incentives by, for example, establishing Special Economic Zones (SEZs), where different rules apply than in the rest of the country where they are established.

Multinational companies are driven to invest in countries with a favorable economic and political environment that has a certain degree of liberalization, affordable interest and exchange rates, and also strong protection of intellectual property rights. In addition, a depreciation of the host country's currency tends to increase FDI inflows, while an appreciation and subsequent increase in the exchange rate has negative effects. Such an environment of good governance, characterized by policies promoting domestic and international competition, transparent legal and regulatory systems, and effective delivery of public services, reduces the additional costs faced by a firm when it decides to invest abroad, related to regulatory, bureaucratic and legal barriers. This has positive effects on all types of FDI. In contrast, a situation of political instability, especially with reference to developing countries, and economic instability have negative effects on FDI.

Liberalization and trade openness have a positive influence on all FDI, particularly vertical and natural resource seeking FDI, which requires a lot of trade. Horizontal and market seeking FDI can be indirectly influenced by this factor, as it can be encouraged by the economic environment and market growth prospects that result from such openness.

A company prefers to invest in countries with which it has cultural similarities, as it foresees easier

adaptation. The social environment is equally important as is a high level of business culture. Finally, even a country's level of corruption has an impact on FDI which, for the most part, is negative as a corrupt system is strongly correlated with bad governance (Dunning, Lundan 2008).

1.4 The effects of FDI in the country of origin and the country of destination

The topic of foreign direct investment is highly controversial, as evidenced by the many concerns of governments arising from the effects they have in the country of origin and the country of destination, that is, to their consequent impact on relative domestic incomes.

Following Barba Navaretti and Venables' (2006) study, these effects can be transmitted in different ways and are classified into three categories: product market effects, factor market effects, and *spillovers*.

Specifically, it is highlighted how the activities of multinational firms have positive effects in both the host and home countries in that these firms, by exploiting the advantages derived from FDI such as economies of scale and access to low-cost inputs, achieve better results than domestic firms that choose not to expand abroad. In fact, multinationals possess characteristics that the latter do not, related to their size, the technology they possess and their management skills. In this sense, the activities of such enterprises can lead to an increase in the efficiency of the domestic production system.

A common concern refers to the fact that a company, by transferring resources and jobs abroad, may reduce the activities it carries out in its home country. In reality, outbound FDI has positive effects on both employment and production in the home country in the long run. In particular, vertical FDI is usually complementary to the activities carried out in the country of origin: moving certain stages of production to foreign countries results in an increase in exports from the country of origin and a general decrease in the firm's costs, which increases the production and employment of complementary activities in the country of origin.

Horizontal FDI, on the other hand, tends to be essentially substitutes for the activities carried out by MNEs in the home country and can lead to a decrease in exports, at least in the short run. In the long run, this type of FDI also results in positive effects on economic activities in the home country.

Moreover, as noted by Lipsey (2004), FDI is capable of preserving the export market even if economic changes occur in the home country, such as changes in the exchange rate, cost increases or other phenomena that could adversely affect the competitiveness of the country's enterprises.

In terms of labor market effects, one relevant consideration concerns the number of wages paid

by multinationals in the destination country. In particular, firms that go international provide higher wages than domestic firms in reference to both developed and developing countries. This fact is associated with the inherent characteristics of multinationals, such as their size and capital intensity. Another interesting factor is skilled labor, which depends on the level of MNEs' activities in both the home and host countries. Considering mainly the effects in the home country, the employment of skilled labor increases when foreign direct investment is made, especially when companies invest in developing countries. In addition, considering job stability, the likelihood of losing one's employment is lower for those working for multinational firms than for employees of domestic firms.

FDI can be made in areas where sources of new technology and expertise are highly concentrated, so it is possible that these investments will lead to a better level of technology and production in the country of origin.

MNEs can have influence on the economic activity of host countries through direct or indirect effects on the performance of firms in the country in which they invest, called *spillovers*. These can take the form of pecuniary externalities, when transactions give rise to an economic surplus, and technological, that is, acquisitions of skills, market knowledge and technology transfer. In reality, the results of these effects are not particularly positive since they depend on the specific characteristics of countries and sectors. A crucial factor turns out to be the absorptive capacity of domestic firms; not surprisingly, firms in poorer countries, lacking the technical capacity to absorb new technologies, cannot benefit from such effects.

In sectors where multinationals have a significant presence and domestic firms are able to interface effectively with them, *spillovers* increase.

Finally, multinational firms could also have an effect on competition in local markets, in particular they could stimulate it by driving out of the market the local firms with the worst returns and thus increasing the average efficiency of the industry.

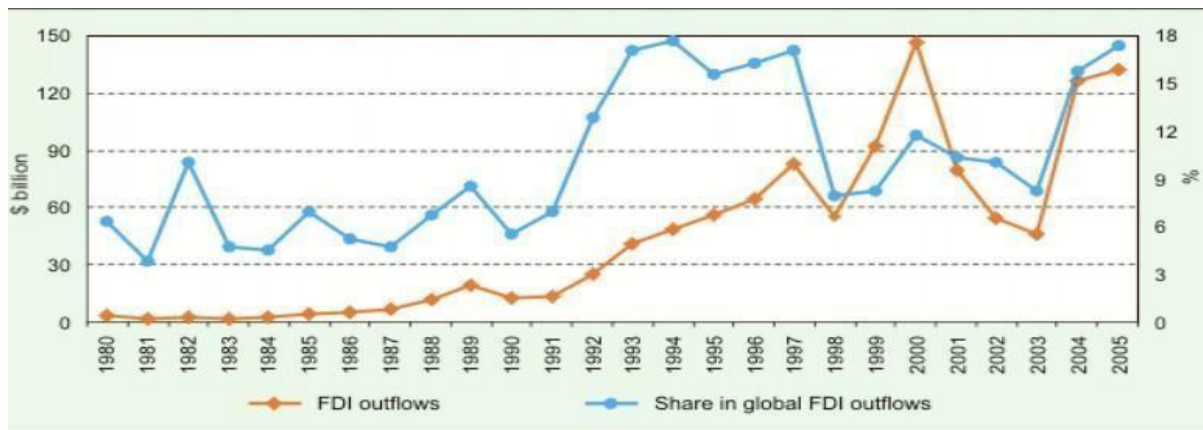
1.5 The case of outbound FDI from emerging and developing economies

The growth of investment by these types of economies dates back to the 1960s and 1970s of the last century, albeit on a smaller scale than the increase realized in the subsequent decades. These were FDI mainly directed toward other emerging close economies and driven by *efficiency* and *market seeking*, or push factors, which relate to the economic environment of the home country and the business strategies that drive a company to invest abroad: domestic market saturation, currency appreciation, cost disadvantages, limited availability of land and labor, need to follow suppliers and

competitors. But it is especially since the early 1990s that flows of FDI outflows from these countries have assumed significant proportions: according to UNCTAD (2006) in 1980 FDI flows amounted to \$3 billion, reaching \$13 billion in 1990 and then increased dramatically in 2005, reaching \$133 billion dollars (Figure 1.1). In particular, FDI of the *strategic asset seeking* type was being carried out, also directed towards developed countries, driven by push factors but mainly by pull, which are related to the location advantages and economic environment of the host country: market potential, cheap labor, incentives, investment opportunities, technology and skills.

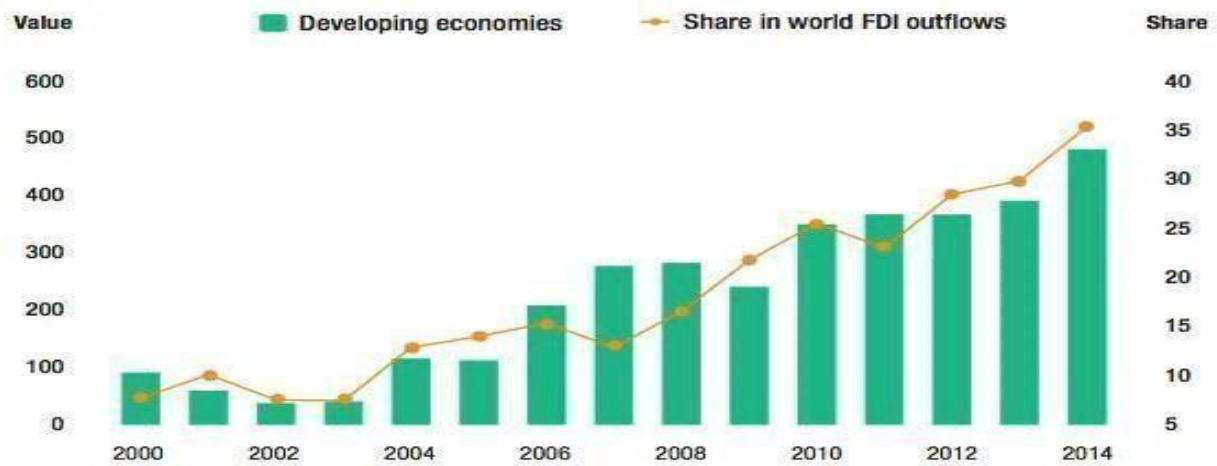
Figure 1.1 - FDI outflows of transition and developing economies and their share in global flows 1980-2005 (billions of dollars)

Source: UNCTAD, 2006.



From 2005 onward, the position of developing countries as a source of FDI has gradually strengthened such that in 2014 they reached the amount of \$468 billion (UNCTAD 2015).

Figure 1.2 - Developing economies: FDI outflows and their share in global flows 2000-2014 (billions of dollars)



Source: UNCTAD, 2015.

Considering the dimensions of this phenomenon, we move on to analyze the theoretical apparatus developed for this type of investment.

We have to consider that despite the increase in FDI from emerging and developing countries, the economic literature has focused especially on the study of FDI and multinational enterprises from developed countries. For this very reason, it seems that the theoretical apparatus developed for FDI is inadequate to explain outbound FDI from emerging economies, particularly with reference to Dunning's OLI model (Gomez-Mera et al. 2015).

There have been attempts, such as that of Gammeloft (2008), which by identifying different waves of this type of FDI and building on the classification of types offered by Dunning, have focused the attention on the determinants and characteristics underlying this phenomenon. In particular, Gammeloft identifies three phases for outbound FDI from developing countries: the first (from 1960 until the mid-1980s) was characterized by *market* and *efficiency seeking* type of FDI, essentially from firms from Latin American countries such as Brazil, Argentina, Venezuela, Colombia and Mexico. The second (mid-1980 to early 1990) was characterized by *efficiency seeking* FDI and dominated by Asian firms from Hong Kong (China), Taiwan (China), China, Republic of Korea, Singapore and Malaysia. In the third phase (from the early 1990s onward), which is highly global and directed in developed and undeveloped countries, an increase in *strategic asset seeking* FDI is identified. Dunning, Kim and Park (2008) were interested in the topic by comparing transnational firms from emerging economies with those from developed countries, considering two different periods. Specifically, FDI from emerging economies in the post-globalization period (the period in

which a considerable increase in their scale was observed), is considered, and the fact that, since the 2000s, FDI from emerging economies was mainly aimed at obtaining an increase in assets, is highlighted. This is in contrast to the early *market seeking* and *efficiency seeking* FDI carried out by developed countries in the period before globalization (1960- 1980). In addition, firms in developed economies were investing abroad to exploit their ownership advantages, while developing country firms were focused on rental advantages, especially in the service sector.

Special consideration should be given to the fact that multinationals in emerging economies possess special ownership advantages, derived from the experience and knowledge gained from operating in the home country, which is very often characterized by an unfavorable and unstable economic and political environment, that represent a competitive advantage over rival firms in developed countries (Gomez-Mera et al. 2015). For example, these firms possess less advanced technology but can be better exploited in other developing countries. From this it follows that such firms generally tend to concentrate investment in similar economies.

The theory of stages of internationalization, or the Uppsala model of Johanson and Vahlne of 1977, can serve to explain the different distribution of these FDI's over time: generally firms first invest in culturally similar areas where market knowledge is readily obtainable; later, as experience, knowledge and learning opportunities increase internationally, investment also goes to culturally distant countries.

The mode of entry into a country is also an important aspect as, generally, companies in developing countries prefer to carry out particular types of partnerships such as *joint ventures*, at least in the first acts of the internationalization process, as they reduce entry costs and increase the chances of learning from foreign partners.

One of the crucial factors is the predominant role played by developing country governments in determining the level and direction of investment. A policy of controlling and restricting FDI has been pursued in many countries, with the aim of giving greater priority to local investment, preventing capital flight, strengthening foreign exchange reserves and maintaining control of state-owned assets abroad. These levels of control generally tend to decline when a certain current account surplus is reached. In developing countries, however, governments also have a strong supportive role, in particular they can enhance certain corporate ownership and leasing advantages by, for example, providing preferential access to raw materials, cheap capital and government subsidies.

CHAPTER 2

Chinese outbound foreign direct investments

2.1 Historical trends in Chinese FDI

Chinese companies have been investing abroad since the 1970s, however, the scale of investment during this period remained small, mainly due to the restrictive policies of the Chinese government, which has always had a great influence on the amount and direction of the country's outbound FDI. From 1978 the situation changed with the launch by Deng Xiaoping, then leader of the Communist Party of China, of the policy of economic openness to foreign countries, called "Open Door" (gaige kaifang, 改革开放), which resulted in an initial increase in FDI and the emergence of genuine Chinese transnational enterprises.

Since these years, investment projects, in order to be implemented, had to obtain approval from government agencies (such as MOFERT, Ministry of Foreign Economic Relations and Trade, the ancestor of today's Ministry of Commerce, MOFCOM), but, between 1979 and 1985, this was strongly held in check and, generally, the entities allowed to submit investment proposals were large *state-owned enterprises* (SOEs), including provincial and municipal corporations. After 1985, non-state-owned enterprises were also allowed to submit their investment projects to the approval process, mainly for production and access to foreign markets (UNCTAD 2007a).

It is since the early 1990s that Chinese FDI has seen a significant, though not always steady, increase: since 1992 there was a rapid increase in FDI by state-owned enterprises. This, however, caused a tightening of approval procedures in order to better manage the process, which in turn led to a decrease in Chinese FDI in 1994. Subsequently, the 1997 Asian financial crisis greatly affected the global economy, and FDI from China was also affected (Buckley et al. 2008a).

Since 1998, the Chinese government has begun to encourage the development of FDI both to secure key resources, such as raw materials and technology, and to establish Chinese enterprises with global reach that can compete with foreign multinational enterprises. In 1999 and 2001, respectively, there was the launch and formalization of a new policy by the Chinese government: "Go Global" (zou chu qu, 走出去), a policy of encouragement and support for the internationalization of Chinese firms, which determined the future increase in FDI (Buckley et al. 2008a).

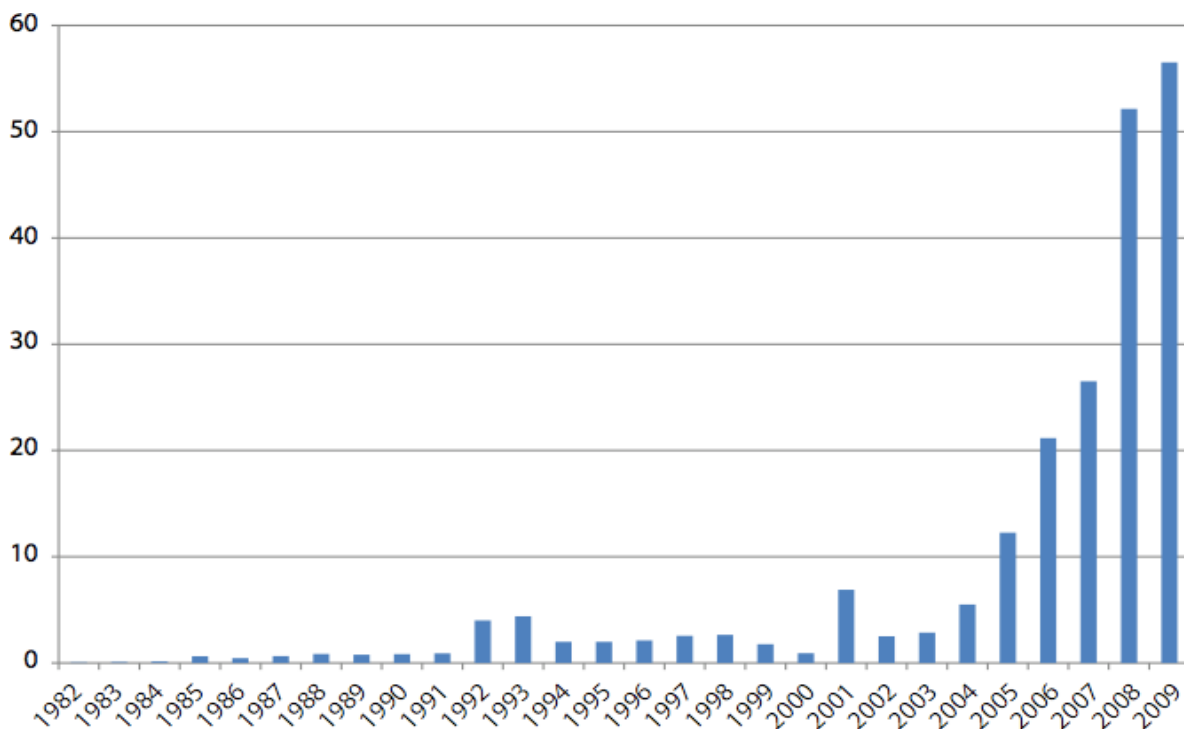
In addition, in 2001, there was a further step toward opening up to foreign countries, namely China's

entry into the WTO (*World Trade Organization*).

Thus since the early 2000s the phenomenon has seen continuous growth: in 2005 FDI flows from China amounted to \$12 billion, and by 2006, Chinese FDI involved 172 countries around the world, touching the value of \$21.16 billion (MOFCOM 2007).

Between 2007 and 2009, despite the global economic crisis that caused a decrease in FDI throughout the Asian region, China recorded an increase: in 2009 outflows amounted to \$56 billion in 177 countries (MOFCOM 2010) (Figure 2.1).

Figure 2.1 - Chinese FDI outflows 1982-2009 (billions of dollars)



Source: Huang and Wilkes, 2011, based on MOFCOM and UNCTAD data.

Not only the scope but also the geographical distribution of Chinese FDI has undergone major changes over the years. As it is highlighted by UNCTAD (2007a), in the early 1990s most Chinese FDI was directed primarily to developed countries, especially North America, attracted by the size of the market, Canada and Australia, aimed mainly at obtaining natural resources. Since the late 1990s, there has been a change in China's FDI location preferences that has persisted over time: investment in developed countries has decreased and increased in those in the developing world, especially in countries in Asia and Africa. Other large-scale flows also began to affect Latin America, Oceania and Europe. This shift represented the choice of a more complex pattern of international expansion of Chinese enterprises, motivated by the growing need of China, whose economy was growing rapidly,

for particular resources, such as labor, raw materials and diversified markets.

The vast majority of enterprises investing abroad were the large state-owned enterprises, which carried out FDI to accomplish certain government objectives and represented certain sectors, such as resources and raw materials (China Petroleum & Natural Gas, China Minmetals Corporation); transportation and communication for import and export business (China Airline, China Foreign Trade Shipping Corporation); heavy industry (China Bao Steel); IT (*information technology*) industry; and electrical, electronics industry (China Mobile, China Telecom, China Electric).

Particularly aggressive in the market were large oil companies such as PetroChina, Sinopec and CNOOC (China National Offshore Oil Corporation), which, for example, were investing in Central Asia to build pipelines in order to meet China's fuel needs. As early as the 1990s, alongside these large state-owned enterprises, there were private companies concentrated mainly in the electrical, electronics sector, such as Haier, Huawei, Lenovo, TCL, Gome and Bird which, in order to prosper, needed to protect local and global markets by strengthening their productivity, gaining access to technology, and their position by entering new markets and promoting brand credibility.

Regarding the mode of entry into the host country, generally, Chinese firms preferred to carry out *greenfield* FDI and strategic alliances, such as *joint ventures*, while M&A-type of FDI was carried out in particular sectors: as reported by UNCTAD (2007a) between 1995 and 2003, most M&A FDI involved the oil and gas, manufacturing, electrical and electronic products, trade and communication, and financial services sectors and was concentrated in five economies: the United States, Australia, Hong Kong, and Singapore.

In 2003 the investment sectors were IT, computers and software, wholesale and retail distribution, but the main sectors were mining and natural resources.

Between 2005 and 2006, China's FDI also increased significantly due to the development of supportive policies, such as the abolition of quotas on the purchase of foreign exchange for FDI (UNCTAD 2007b).

Chinese firms have continued to invest predominantly in Asia, especially in Hong Kong (Special Administrative Region) and Latin America (also major destinations for Chinese FDI in more recent years). However, the data on the general scope of Chinese FDI and the importance of Hong Kong as a destination must be viewed critically in relation to the phenomenon of *round tripping*, that is, when capital is transferred in the form of outbound FDI to "stopover" places only to be brought back to China in the form of investment from abroad and, in so doing, benefit from the preferential treatments reserved for foreign investors. The same problem arises with Latin America, as most FDIs are registered in countries known as tax heavens such as the Cayman Islands and the Virgin Islands (Garcia Herrero, Xia, and Casanova 2015).

The main interest was still in natural resources, under the leadership of the large oil companies CNOOC and CNPC (China Natural Petroleum Corporation), with investments in Africa, Latin America and Central Asia (Kazakhstan), in the mining sector and also in the service sector, with the internationalization of Chinese banks, which began their overseas expansion through M&A and *greenfield* FDI. In contrast, there was a decrease in investment in the manufacturing sector during this period (MOFCOM, 2007).

In addition, in 2006, China engaged in the establishment of an initial group of eight economic and trade cooperation zones, which included African countries such as Nigeria, Mauritius, and Zambia, Asian countries such as Mongolia, Pakistan, Thailand, and Russia, Kazakhstan, and other *Commonwealth of Independent States* (CIS) countries. The establishment of these zones had various motivations: to expand Chinese exports, to develop Chinese enterprises and brands in the global market, to reduce foreign exchange reserves, and to provide employment in host countries, contributing to their economies and bilateral relations. In addition, Chinese enterprises were driven to invest in these zones because they would gain more benefits by expanding abroad as a group rather than individually.

These years saw a trend that would continue in the following's, namely the increase in China's investment in ASEAN member countries, where Chinese firms concentrated in the energy and infrastructure sectors. China also emerged as the leading investor country in low-income countries such as Cambodia and Laos. In addition, there is a change in the mode of entry into the host country as the use of M&A type of investment is consolidated (UNCTAD 2007b).

Between 2007 and 2009, Chinese FDI also increased due to the further development of government-sponsored support policies. During this period, exchange rate fluctuations and falling stock prices abroad caused by the global economic crisis may have created good opportunities for Chinese enterprises to acquire assets at good prices (UNCTAD 2009).

Asian countries continued to dominate among the recipient countries of Chinese FDI, although, again, the largest flows are directed to three destinations: Hong Kong and the *offshore* centers of the Cayman Islands and the Virgin Islands. With China's great economic development, Chinese firms were driven to invest abroad to satisfy their need to secure privileged access to natural resources, such as oil, gas, and mineral deposits, and assets already created: technology, brands, and distribution networks. The manufacturing sector again gained considerable importance, along with mining and finance (MOFCOM 2010).

2.2 The traditional motivations and types of Chinese FDI

Following Buckley et al. (2008a), foreign direct investment undertaken by Chinese firms can be considered under the traditional motivations offered by Dunning (1993): *natural resource seeking*, *market seeking*, *efficiency seeking* and *strategic asset seeking*.

Regarding the first motivation, the acquisition of particular resources and raw materials directed for consumption in the domestic market has been an important determinant of Chinese FDI. With China's particularly rapid economic development resulting from the economic policies adopted by the government over the years (from the late 1970s onward), the demand for raw materials and other inputs, which were scarce in the country itself, has seen a significant increase. In particular, Chinese companies have engaged in FDI in countries rich in natural resources (such as copper, iron and oil) such as Africa, East and Central Asia and Latin America.

The largest investors can be identified in the large SOEs that were pushed to internationalize through forms of government support, especially from a financial perspective, such as CNPC, Sinopec, Shanghai Bao Steel, Sinochem and CNOOC. Even the investments in the early 1990s, directed mainly to developed countries, as well as being driven by the search for large markets, were mainly made to obtain the resources China needed, going against the fact that, generally, companies from emerging economies invest in developed countries mainly to access more advanced technology. Examples are CITIC's (China International Trust and Investment Company, founded in 1979) investments in New Zealand, the United States, Canada and Australia, or even the 2008 acquisition of Rio Tinto PLC in Britain by Chinalco, a Chinese firm of the mining and metals industry.

Market seeking FDI has been carried out by firms both defensively, i.e., to circumvent trade barriers or respond to competitive pressures and weak access in the domestic market, and offensively, i.e., to improve access to foreign markets by establishing sales and production subsidiaries. Chinese firms have always engaged in establishing operations abroad to facilitate trade, as Chinese investors have always had to deal with barriers to trade, both tariff and non-tariff, and in the early 1990s Chinese FDI in services served this very purpose. In particular, it seems that the imposition of protectionist measures stimulates the expansion of Chinese firms since they, in response to such measures, set up production facilities abroad, especially in states with which industrialized countries have few export quotas and few *anti-dumping* measures (designed to hinder the sale of foreign goods and a lower price than in the domestic market), such as Cambodia, Mauritius, Jamaica and Fiji.

Another aspect of defensive FDI *market seeking* is the limited capacity for growth and expansion at the domestic market level. It must be considered that China's entry into the WTO has opened the domestic market to imports and inbound FDIs from foreign countries, leading to strong domestic

competitive pressure, in addition to which, in many sectors, such as machinery and textiles, supply chain bottlenecks, limited demand and fragmented domestic markets have been found, leading to overcapacity. In addition, it is often easier for Chinese companies to develop markets abroad than domestically, due to the more transparent regulatory system and the many distribution networks that can be found in foreign countries.

Chinese enterprises have also carried out FDI *market seeking* of the offensive type, that is, to develop new markets and increase brand recognition. Although starting from a weak condition, Chinese enterprises have managed to gain a competitive position internationally, not only by selling simple and mature products in low-income countries, but also by penetrating high-tech sectors in industrialized and non-industrialized countries. Examples include electronics firms such as Huawei, Lenovo Corporation, Haier and other firms in the plastics, pharmaceutical and chemical sectors. Chinese companies have also made efforts to establish sales and *marketing* activities in certain markets to decrease their dependence on middlemen, for example, Sinochem established six overseas affiliates to expand chemical sales in large foreign markets.

Offensive *market seeking* FDI has been undertaken with the aim of strengthening the regional economic integration of Chinese enterprises in certain parts of the world. For example, Chinese investments in Mexico have been made so as to benefit from the preferential treatment offered by the United States to Mexican imports, under the terms of NAFTA (North American Free Trade Agreement). Other examples include investments in ASEAN member countries such as Cambodia, Laos and Vietnam.

As for FDI *efficiency seeking*, these are generally carried out once FDI *resource seeking* and *market seeking* have been completed and to exploit the benefits of regional economic integration and the international division of labor. In fact, firms tend to exploit the different factor endowments (such as labor) of the various countries. While multinationals in industrialized countries have undertaken numerous such investments, these do not seem to have been a predominant type for Chinese firms. This may be explained by the fact that these firms did not need to seek production efficiencies abroad since the Chinese market already offered a large amount of cheap labor and other inputs. However, this type of investment has become much more common in recent years given the expansion of Chinese firms' international activities and the rising cost of inputs in the country (UNCTAD 2013). Chinese enterprises have undertaken *strategic asset seeking* FDI because they have always been interested in foreign assets, both tangible and intangible. These were generally interested in acquiring information on foreign economic and trade conditions and were encouraged by the Chinese government to focus on assimilating the knowledge and experience of foreign management skills, with the aim of improving the competitiveness of Chinese enterprises internationally. The latter,

however, began to take advantage of foreign knowledge related to technology-intensive production and local markets. For this very reason, Chinese companies have established research-oriented affiliates in high-income countries, such as the United States and Britain, to develop technology-intensive products at home and export them through sales affiliates.

Chinese companies have also sought other intangible assets such as brands and complementary assets: some companies such as Lenovo and Haier have extended their brands into foreign markets, achieving some success, while other companies have considered it much faster and more effective to acquire Western brands and *marketing* channels, such as TCL's 2003 acquisition of France's Thomson Electronics.

An additional intangible asset of particular interest was improved access to capital markets since China's capital market had long been inefficient and the government generally produced restrictive policies with reference to SOEs underwriting. In particular, it was difficult to obtain capital, especially for investments in sectors that were not considered priorities for the government. Thus, in the early 1990s, Chinese firms used special stratagems, for example, they acquired weak Hong Kong firms, turning them into multinational enterprises in order to be listed on the country's stock exchange and obtain capital to be redirected to the parent company in China. In addition, investments were made in tax heavens such as the Cayman Islands, the Virgin Islands and Bermuda to obtain venture capital (risk capital provided by financial to other companies to start or grow businesses with high development potential), to transfer funds to China and to circumvent the approval process for FDI (Buckley et al. 2008a).

2.3 Policy development and the stages of Chinese FDI

In general, we need to consider that China's economic development in recent decades has been particularly remarkable, and since the formulation of the "Open Door" policy in 1978, the country's economic reforms have sought to gradually transform China's planned economy into a form similar to that of a market economy, moving in the direction of greater economic integration of the country globally.

In this context, Chinese outbound FDI has become particularly important, and China, from being a major destination country for FDI, has become an important source of investment among developing countries.

Voss, Buckley and Cross (2008) address the issue of Chinese FDI development by making use of institutional theory. This has been used to explain the motivations and behaviors behind international economic activities: institutions determine the "rules of the game" and influence the environment in

which international activities are located, the transaction costs and those related to information gathering that firms incur when investing abroad. It has generally been applied to inbound FDI, but Voss, Buckley and Cross (2008) use it to analyze the relationship between a country's institutional changes and its outbound FDI, identifying five stages of Chinese investment.

Following Voss, Buckley and Cross (2008), in order to do so, one must first identify the major administrative and political bodies that deal with laws and regulations related to Chinese FDI, namely the State Council, MOFCOM, Ministry of Commerce, SAFE, State Administration of Foreign Exchange, NDRC, National Development and Reform Commission, SASAC, State Owned Assets Supervision and Administration Commission, Ministry of Finance and the People's Bank of China.

The State Council is the highest organ of the central government and is responsible for developing laws and regulations and coordinating national economic development, and also manages foreign affairs and bilateral treaties.

MOFCOM was established in its current form in 2003 and is responsible for overseeing outbound FDI, implementing policies and regulations, and approving FDI projects in non-financial output, manages bilateral and multilateral investment negotiations and trade treaties, and represents China in the WTO and other international organizations. In addition, MOFCOM ensures that economic and trade laws are in line with international treaties and agreements and coordinates foreign aid policy and other related financing mechanisms.

The SAFE was established in 1979 under the authority of the Bank of China and is responsible for managing foreign exchange use and flows. In 1982, the SAFE came under the authority of the People's Bank of China and remained relatively independent until the government restructuring in 1998 that increased the SAFE's FDI responsibilities: reporting balance of payments data to the State Council and the International Monetary Fund, advising on foreign exchange policies to the People's Bank of China, supervising the transfer of foreign exchange out of and into China under the balance of payments capital account, and managing China's foreign exchange reserves.

The NDRC is the main government body that regulates and coordinates national economic development and industrial policies. Its functions include monitoring government investment in domestic industries and developing policies to support Chinese outbound FDI. This task is accomplished by the NDRC with the publication of guidelines for domestic enterprises' access to soft loans to finance their internationalization and a catalog of host countries for which the Chinese government offers subsidies for FDI projects. This committee is also involved in the approval process for investment projects: projects involving the use of a large sum of foreign currency or involving particular sectors, such as natural resources, must first obtain approval from the NDRC.

SASAC was established in 2003 to represent the Chinese government in non-financial state-owned

enterprises; prior to its establishment, this function was performed by other ministries and government authorities. SASAC's goal is to ensure that companies under its supervision remain competitive and increase their profitability and the value of the assets they control. However, it is uncertain whether this goal is met since SASAC's supervision is divided into two levels, national and provincial, each of which exercises its power by appointing managers of state-owned enterprises and making important decisions in the enterprises under their control. Most executives are appointed directly by the Chinese Communist Party, which implies that, very often, the most suitable candidates are not appointed, decisively influencing national and international operations of the enterprises. SOE investment projects under the supervision of SASAC must obtain approval from this body.

The Ministry of Finance, established in 1949, is in charge of developing plans and policies for the tax sector, and in the field of FDI, its main responsibility is related to negotiations and agreements regarding foreign tax activities.

The People's Bank of China was established as the Central Bank of China in 1983 and is supervised by the State Council. The institution is responsible for all financial policies and, in addition, is in charge of maintaining relations with international financial organizations such as the World Bank and managing China's foreign exchange reserves. With reference to this last task, in 1994 the People's Bank of China made numerous changes by strengthening foreign exchange control. The BPC used to be in charge of financial services and, therefore, foreign investment by financial institutions, but in 1992 this task was handed over to other authorities, including the China Banking Regulatory Commission, which approves FDI projects of Chinese banks (Voss, Buckley and Cross 2008).

2.3.1 The five stages of Chinese FDI

Following the study by Voss, Buckley and Cross (2008), five phases of Chinese FDI are identified: the first which is identified includes the period from 1979 to 1985, that is, the time when the first steps were taken towards foreign investment. Since the launch of the "Open Door" policy, in fact, the Chinese government has been engaged in creating an institutional environment to attract foreign multinationals to China and encourage Chinese companies to invest internationally. Specifically, the State Council allowed some SOEs to establish foreign affiliates for certain reasons: securing access to scarce natural resources at home, access to technology to transfer it to China, increasing the possibility of realizing exports for Chinese enterprises and acquiring the appropriate management skills. The Chinese government supported the formation of *joint ventures*, to facilitate the transfer of technology and management experience to China and decrease the risks of carrying out economic activities abroad.

This was supposed to show that outbound FDI would become an integral part of the Chinese economy and contribute positively to social welfare. However, in the 1980s, there were concerns about the positive effects of outbound FDI and, more importantly, it was believed that it represented a departure from socialist ideology, all of which was reflected in the reforms of these years designed to reinforce state control over industrial production and reaffirm the power and interests of bureaucrats in companies under their supervision. In addition, since the 1970s, China's macroeconomic policies have focused on the accumulation of foreign exchange: only enterprises that were licensed to export could retain a given amount of foreign exchange revenue while the rest had to be surrendered to the Chinese government. The portion retained by enterprises, however, could not be used freely: if one wanted to engage in FDI, one had to seek approval from the SAFE. Once approval was obtained from this agency, the investment project had to be submitted to MOFCOM and the NDRC (for investments worth more than \$10 million), providing these agencies with the required documentation (such as a feasibility study, the SAFE's certificate of approval, and other documents related to the country in which the investment was to be made). These restrictive measures may explain the slow growth of FDI in these years; it was not until 1985 that the main regulatory framework on FDI control and approval was published. In spite of the unfavorable institutional environment since 1983 more and more foreign affiliates were established, especially in industrialized countries, and among the first companies to invest abroad were CITIC, Sinotrans, and China Minmetals Corporation.

The second phase of Chinese FDI encompasses the years from 1986 to 1991 and corresponds to a period of government encouragement of FDI. In 1985, restrictive policies and the approval process were simplified; specifically, even non-state-owned enterprises were granted permission to apply for approval to invest abroad. In fact, private enterprises had already been recognized in 1982 as additional entities of SOEs. It was not until 1988 that private ownership was clearly defined, in 1997 it was considered an integral part of China's economy, and in 1999 its legal status was strengthened. Finally, private enterprises were officially given the ability to invest abroad only in 2003.

SAFE and MOFCOM during this period engaged in redefining FDI regulations and in 1989 formulated one on the use of foreign exchange earnings. In 1991, the NDRC took steps to strengthen the management and approval of investment projects.

During this period, China's FDI growth was also driven by another factor: China's economic development strategy was based on export-led growth, this led the Chinese government to devalue the national currency, the RMB, to support Chinese exporters and favor FDI that involved the transfer of physical equipment and raw materials.

In addition, Chinese FDI was promoted by the gradual shift to a more transparent and liberalized

system and improvements in technology and management knowledge of enterprises. International investment increased rapidly during this period, and the favored direction was still developed countries, mainly North America.

The third phase of Chinese FDI covers the period from 1992 to 1998. In 1992, in fact, Deng Xiaoping made the trip to southern China to reiterate his support for market opening and economic reforms, based on the idea of market socialism, which envisioned that Chinese society could maintain itself as such while becoming a market economy. This journey represented a departure from the restrictive policies that characterized the period following the Tiananmen Square incident in 1989 and a moment of liberalization that led to FDI being seen as an integral part of China's national development and strongly supported by the Chinese Communist Party. Thus provincial and local authorities engaged in overseas activities, even granting permission to enterprises under their supervision to establish foreign affiliates. However, this trend was interrupted when MOFCOM suspected embezzlement of public funds in connection with some international activities and with the 1997 Asian financial crisis. All this caused the adoption of restrictive measures in approval procedures and an increase in the control of FDI projects.

During this period the approval systems of each government organization were defined, for example, MOFCOM and NDRC were responsible for investments that were worth more than \$30 million, while the State Council was responsible for those below this figure. The SAFE, at the national and local levels, was responsible for investments of lesser value (\$1 million). Other reforms were carried out with regard to foreign exchange revenue: before 1994, only enterprises that had been granted international trade rights could use this revenue to finance FDI projects, but, after this year, the Chinese government adopted a different policy, which also allowed enterprises that did not possess this revenue (from trade) to purchase foreign exchange. This represented a crucial fact since it allowed Chinese enterprises to finance their international investments by converting domestic currency into foreign currency.

At this stage, a lot of FDI was being carried out in developed countries, not only in North America, but also in Australia especially with reference to *natural resource seeking* FDI through large acquisitions.

The fourth phase of FDI covers the years from 1999 to 2001, and is characterized by MOFCOM's encouragement of overseas investment, especially in assembly plants to support exports by Chinese enterprises themselves. Also in 1999, the "Go Global" policy was launched, strongly supported by then-President Jiang Zemin and Prime Minister Zhu Rongji, which was later formalized in the Tenth Five-Year Plan (2001-2005). This policy was formulated to support and encourage, both financially and administratively, the internationalization of Chinese enterprises, with the aim of strengthening

their competitive advantages and, indirectly, the reconstruction and development of China, which now felt capable of gaining a position of prominence in the international economic arena. Specifically, in the Tenth Five-Year Plan, the objectives of this policy were reiterated with reference to FDI: increasing Chinese outbound FDI, facilitating strategic investment in the natural resources sector, and developing internationally competitive Chinese multinational enterprises.

At this stage, there was a change in the geographical distribution of Chinese FDI, which mainly went to developing countries such as Africa, Latin America and the Caribbean, and Asia, South and East, instead of developed countries.

This trend in the spatial distribution of Chinese investment is also maintained in the latest phase from 2002 onward, in which there is a continuous increase in FDI that will make China one of the largest investing countries globally. At this stage, the business environment for Chinese enterprises changed significantly due to China's entry into the WTO in 2001 and the formalization of the "Go Global" policy in the Tenth Five-Year Plan. Specifically, in order to succeed in joining the WTO, China engaged in a gradual opening of its domestic market, which led to increased domestic competition and prompted Chinese enterprises, especially private enterprises that did not enjoy policy protection, to undertake overseas investment in search of new markets. Against this backdrop, the Chinese government took steps to facilitate the implementation of FDI: first, it decentralized the approval process, entrusting it to subnational government authorities; second, it simplified the documentation required for the approval process by removing the feasibility study (but put the focus on the actual managerial capabilities of the enterprise intending to invest abroad); third, enterprises were allowed to raise funds in international financial markets to implement their FDI. Since 2002, steps were taken in the liberalization process: changes were made in the system for approving the use of foreign currency, for example, the SAFE abolished the assessment of foreign exchange risk and allowed Chinese companies to use foreign currency, prior to final approval, up to a maximum of 15 percent of the total investment to cover installation costs (Voss, Buckley and Cross 2008).

In 2004, China's FDI policies were formalized in several regulations, published by MOFCOM and the NDRC, regarding measures on the approval process and incentive systems for FDI encouraged by the government, such as resource exploration projects (in cooperation with the Export-Import Bank or EXIM), export of domestic technologies and products, establishment of R&S (Research and Development) abroad to utilize advanced technology, and projects involving M&A, as they can improve the competitiveness of Chinese enterprises internationally and provide a quick method of entry into new markets.

In the 11th Five-Year Plan (2006-2010), the Chinese government continued to focus on the "Go Global" policy and its importance to China's businesses and economy.

In 2006, the SAFE lifted the limit on the amount of foreign currency that domestic enterprises could have for FDI and more autonomy was granted to its local subsidiaries. The State Council published a general guidance on FDI, the *Opinions on Encouraging and Guiding Foreign Investment and Cooperation by Chinese Enterprises*, where the main objectives of the policies were affirmed: to facilitate China's economic restructuring, to improve the international competitiveness of Chinese enterprises, to promote cooperation with countries where Chinese FDI is carried out, and to promote China's economic development.

In 2009, MOFCOM published the *Administrative Measures for Overseas Investment*, which made changes regarding MOFCOM's approval process of FDI, which was increasingly streamlined and decentralized to the agency's local departments, with the exception of investments related to strategically sensitive areas. In addition, among these measures, guidance is offered to Chinese investors on how to operate in host countries.

More recently, in the Twelfth Five-Year Plan (2011-2015), the "Go Global" policy is reaffirmed and guidelines for the FDI policy framework are given, specifically, the government's role is emphasized in three areas: supporting the participation of Chinese enterprises in foreign natural resource projects, achieve technology upgrading and realize expansion in foreign markets. Chinese private enterprises are also encouraged to invest abroad, especially small and medium-sized enterprises.

Thus, China has equipped itself with an FDI regulatory framework suitable for the promotion and support of this type of investment. In general, it is intended to support Chinese enterprises that have taken an internationally competitive position and to promote the country's domestic development. China, unlike most emerging countries, has many tools aimed at facilitating, supporting and encouraging FDI, such as the provision of information, investment insurance, financial and tax support, linkages to development assistance programs and international investment agreements, priority access to loans and foreign currency, and faster approval process. These tools are available to SOEs and private enterprises, although state-owned enterprises may benefit.

However, further improvements need to be made, especially in relation to the approval process involving numerous agencies. In particular, non-financial enterprises need approval from MOFCOM and the NDRC before implementing an FDI. If state-owned enterprises are involved, the investment project must also be submitted to SASAC. Finally, SAFE is in charge of the process of reviewing the approvals obtained from the other agencies. Financial enterprises, in order to undertake FDI, must seek approval from the NDRC, the People's Bank of China, and other commissions such as the China Banking Regulatory Commission. This type of approval process creates additional costs for Chinese firms investing abroad, on top of the costs of investing in foreign countries and being *newcomers* to the FDI market. Thus, it seems that the system, while advanced, needs reforms that should be on the

agenda of current President Xi Jinping: while in the past NDRC approval was required even from investment projects that were worth \$100 million, since 2014 it is required only for projects that exceed the value of \$1 billion (Sauvant, Nolan 2015).

2.3.2 Chinese FDI in recent years

From 2009 onward, Chinese outbound FDI has continued to increase, and China, from being a large receptacle for investment from the rest of the world, has consolidated itself as a major source country for FDI globally.

Since 2010 investment from the Asian region has seen a sharp increase. In particular, the two largest sources of FDI were Hong Kong and China, whose flows outbound amounted to \$68 billion and for the first time exceeded those from Japan. The preferred mode of entry into the host country, as reported by UNCTAD (2011), was still the M&A type. China, during this period, strengthened its position as an investor country in the extractive industry. Chinese companies went to resource-rich countries such as Australia and Canada in the developed world and to Iraq, Sudan and Uzbekistan in the undeveloped world. Sub-Saharan Africa continued to be a major destination for Chinese FDI, as did Latin America, the Caribbean and Oceania. Asia remained the largest receptacle for FDI from China, with Hong Kong in the primary position, followed by Singapore. As we will see, since 2008 European Union countries have also become an important location for Chinese investment.

Advanced technology, brands and distribution channels are among the main pull factors. However, very often Asian companies in general, including Chinese companies, having become particularly strong in the M&A market, have faced (and are still facing) strong political obstacles designed to curb *strategic asset seeking* FDI. This is demonstrated, for example, by the attempts by Huawei Technologies (China) to acquire U.S. companies (3Com and 3Leaf) in 2008 and 2010. Other similar cases had happened before: in 2005, CNOOC's acquisition of the U.S.-based company Unocal, which had oil interests in Central Asia, failed due to opposition from a large group of U.S. congressional representatives who felt that the Chinese company's investment motives could jeopardize the country's regional and economic security. In the same year, Haier, the world's leading home appliance company, also failed to complete its acquisition of the U.S.-based company Maytag. In 2009, Chinalco announced an investment in mining company Rio Tinto (Australia), but after a short period, the Australian company withdrew from the deal due to public concerns about the increasing level of Australian natural resources becoming Chinese-owned.

Finally, in 2015 Chinese FDI reached \$128 billion, China thus consolidated its position as the third largest investing country in the world, after the United States and Japan, making investments in both

developed and undeveloped countries.

In particular, following the willingness to invest in technology and brands, Chinese companies have completed large contracts in developed countries: the home appliance company Haier's acquisition of the U.S. company GE Appliances, the Chinese Wanda Group's large acquisitions in the industry of U.S. entertainment and, finally, the acquisition by ChemChina (a company increasingly active in Europe) of the Italian company Pirelli in late 2015.

As for developing countries, China became one of the leading nations in investing on the African continent: for example, in Tanzania it became the second largest foreign investor with Chinese multinationals investing \$2.5 billion in 500 projects, mostly in manufacturing. FDI outflow from China in 2016 grew by 44 percent to \$183 billion thanks mainly to an increase in acquisitions by Chinese firms, making China, for the first time, the second largest investor with Chinese firms focusing their foreign investment on manufacturing and service industries. In 2017, the outflow of FDI from Asian developing countries dropped 9 percent from \$385 billion in 2016 to \$350 billion in 2017, due especially to the decline in China which recorded a 36 percent drop to about \$125 billion and which was the result of policies to suppress FDI outflow in reaction to significant capital outflow in the previous two years. Indeed, in late 2016, the Chinese government identified several irrational investments in certain sectors and began to curb foreign investment in precisely those sectors: including real estate, hotels, cinemas, and entertainment (UNCTAD, 2012; 2013; 2014; 2015; 2016; 2017; 2018).

CHAPTER 3

Chinese foreign direct investments in the EU

3.1 Characteristics and peculiarities of Chinese investments in the EU

The large flow of Chinese investment into Europe began in the wake of the 2008 global financial crisis as a result of the emergence of profit opportunities from the forced privatization of enterprises that were previously state-owned. And it is precisely the sudden development and rapid growth of Chinese investments in Europe (and the world) that constitute the first peculiar characteristic of the latter (Knoerich and Miedtank, 2018). The investments of Chinese companies were dictated by the desire to take advantage of falling commodity prices and at the same time acquiring technology and know-how to support the development of the domestic market as well as in the name of the close economic and trade ties between the two regions.

The reasons explaining China's interest in the EU as an investment vessel can again be divided into "push" and "pull" factors. The "push" factors refer to the saturation of the Chinese market and the strong competition present in some sectors, which pushes companies to invest abroad in order to seek new markets in which to sell their products. On the contrary, the "pull" factors relate to the presence in Europe of a large and sophisticated market characterized by consumers with high purchasing power, political stability, efficient institutions, a highly skilled workforce and advanced technology (Lorenzi, 2019).

As we have already experienced, historically FDIs were implemented by advanced economies to less developed countries, finding success in foreign markets by exploiting their technological or managerial superiority or in general their competitive advantage; Chinese investments, in this case, turn out to be peculiar in that the country of origin is precisely an emerging economy that invests a considerable share in more developed regions such as Europe, despite technological and managerial weakness and inexperience in the international arena. This peculiarity of Chinese FDI exposes two other peculiarities: first, Chinese multinationals likely possess a set of advantages that make them suitable for investing in advanced economies. These advantages are categorized into "special ownership advantages" (which include resilience, frugality, and strong Chinese business networks) and "country-specific advantages" (such as low labor costs, government support, favorable

institutions, and easy access to funds). Second, Chinese investment in Europe has often been driven by a desire to overcome firm-specific weaknesses. In fact, many Chinese multinationals instead of exploiting ownership advantages, have sought advantages through FDI strategic asset-seeking in Europe (for example by establishing R&D centers in Europe to tap local expertise) (Knoerich and Miedtank, 2018).

Moreover, Chinese multinationals have adopted approaches to FDI usually not seen in Western or Japanese ones, stemming from their "latecomer" status, lack of international experience, characteristics of the Chinese market and certain cultural preferences. In fact, unlike traditional investors (i.e. from the United States), Chinese multinationals tend to leave the European companies they acquire largely unchanged, keeping the acquired company's management intact and granting it a good deal of autonomy, with the result that many European subsidiaries acquired by Chinese multinationals operate very independently of the Chinese headquarter.

Another interesting anomaly concerns the domestic market orientation of many Chinese investments in Europe. In fact, taking on an international profile or taking ownership of a European company through an acquisition, sometimes enhanced the reputation in the domestic country. In addition, many Chinese investments in Europe were intended to facilitate increased sales of European products in the Chinese market.

An additional distinguishing feature, from a European perspective, is the "quality" of the EU's political relationship with China as a source country for FDI. For the first time, a country that is not a strong political and security ally of the EU and is not a firm supporter of the liberal international economic order has become a major source of FDI in Europe. This exacerbates some of the problems related to the idiosyncratic nature of Chinese investments and has created controversy in Chinese FDI in Europe, fueled by the fact that these very investments remain relatively misunderstood, despite widespread interest and analysis. Therefore, because of the uncertainties about the origin and idiosyncrasy of Chinese FDI, opinions and approaches toward it differ: on the one hand, Chinese investments are welcomed and viewed as an important current and future source of capital and jobs, and thus European governments promote them (particularly *greenfield* investments). On the other hand, there is an intensification of concerns about the appropriation of technology by Chinese multinationals through acquisitions of high-tech firms, about the possibility of unfair competition when Chinese firms are state-owned or state-supported, and about the possibility of Chinese investment of undermining labor and environmental standards (Knoerich and Miedtank, 2018).

3.2 Chinese FDI in Europe: distribution and motivations

As we have previously observed, cross-border acquisitions of Chinese companies in advanced countries are generally considered the fastest and most effective means of accessing strategic assets and key capabilities. They are a key strategy for Chinese multinationals to acquire technology and brands, deepen marketing and R&D capabilities, access distribution networks, and generally increase their managerial and organizational capabilities. Through these acquisitions, Chinese multinationals lacking firm-specific technological advantages may be able to close their technological gap with incumbent firms in advanced countries by acquiring new capabilities and skills in organization, technology and management. In addition, through acquisitions, Chinese multinationals seek to access local knowledge present in the regions where the target firms are located, through the development of formal and/or informal networks with local actors such as suppliers, customers, universities and research centers. Therefore, regions with strong technological bases provide opportunities for Chinese multinationals to tap into a rich pool of knowledge and upgrade their technological capabilities and competencies accordingly.

The latter are also the reasons behind the growing Chinese presence in the European continent, at least since the recent past. As revealed by the analysis of Amendolagine and Rabellotti (2017), in fact, between 2003 and 2014 the countries that received the majority of Chinese investments are Germany, the United Kingdom, France, the Netherlands, Italy and Spain. These countries account for nearly 76 percent of total Chinese investment in the EU. Other important destinations are Hungary, Ireland, Poland, Romania and Sweden.

Interesting differences also emerge when considering the geography of investments and their mode of entry. Greenfield operations are more prevalent in all EU countries and are also located in Central and Eastern Europe (especially in Bulgaria, Hungary, Poland and Romania). Mergers and acquisitions, on the other hand, are much more concentrated in the EU's "core" and northern countries (Finland and Sweden).

Figure 3.1 – Top Chinese FDI destinations in the EU (number of deals and percentage)

	Mergers and acquisitions	Greenfield	Total
Germany	54 (26.3)	404 (39.3)	458 (37.1)
United Kingdom	41 (20)	161 (15.6)	202 (16.3)
France	27 (13.2)	77 (7.5)	104 (8.4)
Netherlands	24 (11.7)	42 (4.1)	66 (5.3)
Italy	16 (7.8)	41 (4)	57 (4.6)
Spain	6 (2.9)	43 (4.2)	49 (4.0)
Total above	168 (82)	768 (74.6)	936 (75.8)
Total EU	205 (100)	1029 (100)	1234 (100)

Source: Amendolagine and Rabellotti (2017)

Figure 3.1 provides a snapshot of the main destination countries in the same period (2003-2014). Germany is by far the favorite destination for Chinese investments, receiving 37 percent of the total (458 deals): 39 percent of greenfield projects (404 deals) and 26 percent of mergers and acquisitions (54 deals). The United Kingdom follows at some distance, with less than half of the direct investment in Germany (202), but with the number of mergers and acquisitions being only slightly lower than in Germany (41). The other European countries receiving a large number of investments are France (104), the Netherlands (66), Italy (57) and Spain (49). In general, greenfield investments are by far the preferred mode of entry, reaching 83 percent of total investments (1,029 out of 1,234).

Figure 3.2 – Top destination sectors in the EU (number of deals and percentage) (2003-2011)

Sector	Mergers and acquisitions	Greenfield	Total
Automotive	13 (7.7)	49 (7.2)	62 (7.4)
Communications	0 (0.0)	97 (14.4)	97 (11.5)
Electronics	14 (8.3)	114 (16.9)	128 (15.2)
Machinery & engines	35 (20.8)	79 (11.7)	114 (13.6)
All sectors	168 (100)	673 (100)	841 (100)

Source: Amendolagine and Rabellotti (2017)

From what concerns the sectoral and investing levels across the different entry modes, as we can see from Figure 3.2, in the period 2003-2011 Chinese FDI in Europe is highly concentrated not only in terms of destination countries, but also in terms of destination sectors. In particular, nearly half of Chinese investment (48 percent) is directed to just four sectors: electronics (128 transactions), machinery and engines (114), communications (97) and automotive (62) (Amendolagine and Rabellotti, 2017).

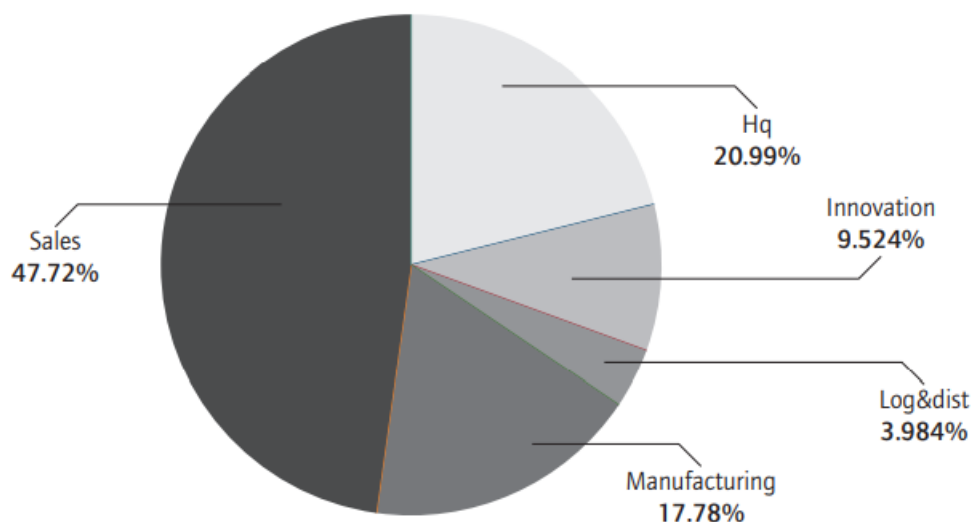
Figure 3.3 - Investments in top destination sectors and top destination countries (number of deals and percentage) (2003–2011)

Sector	France	Germany	Italy	Netherlands	Spain	UK	Total
Automotive	0 (0.0)	19 (12.7)	8 (29.6)	3 (21.4)	0 (0.0)	16 (34.8)	46 (16.7)
Communications	12 (48.0)	17 (11.4)	8 (29.6)	4 (28.6)	5 (35.7)	16 (34.8)	62 (22.6)
Electronics	4 (16.0)	45 (30.3)	9 (33.3)	4 (28.6)	9 (64.3)	5 (10.9)	76 (27.6)
Machinery & engines	9 (36.0)	68 (45.6)	2 (7.5)	3 (21.4)	0 (0.0)	9 (19.5)	91 (33.1)
Total	25 (100)	149 (100)	27 (100)	14 (100)	14 (100)	46 (100)	275 (100)

Source: Amendolagine and Rabellotti (2017)

For the same period, Figure 3.3 shows the distribution of Chinese FDI among the main destination sectors and the main EU destination countries, presenting a highly concentrated pattern. As we can see, the machinery and engines sector receives the largest share of Chinese investment in Germany and the United Kingdom (45.6 percent and 33.1 percent of total investment, respectively); in Italy and Spain, the most targeted sector is electronics (33.3 percent and 64.3 percent, respectively); and finally, communications is the most targeted sector in France (48 percent) and in the Netherlands (along with electronics with 28.6 percent).

Figure 3.4 – Distribution of investment along the value chain (2003-2014)



Source: Amendolagine and Rabellotti (2017)

Figure 3.4 shows that most Chinese greenfield investment in the EU is for commercial purposes (48 percent), classified into sales, marketing and retail activities. Headquarters and manufacturing

activities are also important, accounting for 21 percent and 18 percent of all activities, respectively. Finally, innovative breakthrough activities (R&D, design, development and testing, and training), along with logistics and distribution activities currently account for a smaller share of Chinese investment (9.5 percent, respectively) (Amendolagine and Rabellotti, 2017).

Finally, the geography of Chinese investment in the EU appears to differ depending on the business activities undertaken. In particular, while commercial business activities are more evenly distributed across European countries, higher value-added activities (headquarters and innovation) are more concentrated in the "core" of the EU, such as France, Germany, Italy, and Netherlands. On the contrary, manufacturing activities are mostly associated with investments made not only in the "core" EU, but also in low labor cost economies in the eastern part of the EU (Poland and Romania).

As a matter of fact, acquisitions in Germany appear to be mainly in the automotive industry and the mechanical engineering industry, both of which are highly locally specialized. In the automotive industry, Chinese companies have also made acquisitions in the United Kingdom and France, targeting regions with strong specialization in the industry, such as the southern Alpine region of France. In Italy, Chinese acquisitions are in the manufacturing sector (mainly electronics and machinery) in Lombardy.

In Belgium and Portugal, Chinese multinationals have made acquisitions in the chemical sector and in Austria in the automotive industry. In the Netherlands, half of the acquisitions are in the chemical and electronics sector (mainly in the western region). At last, in the IT and programming sector, Chinese acquisitions are in France and the United Kingdom (Amendolagine and Rabellotti, 2017).

Finally, Figure 3.5 shows the geographic origin of Chinese multinationals that have undertaken medium- and high-tech acquisitions in the EU. More than 60 percent of them come from only four provinces: Beijing (25 percent), Hong Kong (18 percent), Zhejiang (11 percent), and Jiangsu (7 percent). Other important source regions are in the eastern part of the country-Shanghai, Jiangxi, Shandong, and finally Guangdong, bordering Hong Kong.

In conclusion, Amendolagine's and Rabellotti's analysis (2017) show that Chinese FDI in Europe is concentrated in a few host countries (the largest European economies), which account for the majority of Chinese investment in the EU. Moreover, they are concentrated in a few sectors, namely automotive, communications, electronics, machinery and motors. Central and Eastern Europe is an important destination for greenfield investments for manufacturing purposes, suggesting that intraregional differences in the business environment are relevant elements driving Chinese investors' location choices.

Figure 3.5 - Geographical origin of Chinese high-tech mergers and acquisitions (2003–2011)



Source: Amendolagine and Rabellotti (2017)

An increasingly important motivation for Chinese investment is the acquisition of strategic assets, which occurs through greenfield investments and increasingly through acquisitions. There is evidence that acquiring knowledge and technology are complex activities that require strong absorptive capacity and signal that Chinese multinationals are rapidly learning to be successful in their asset-seeking acquisitions.

3.2.1 Geely-Volvo case study

According to Balcet, Wang and Richet (2017), Chinese catch-up process in its early stages was mainly driven by technology, aimed at achieving low-cost and low-price solutions for the production of low-end products. At the same time, overseas market expansion was the consequence of fierce competition in the Chinese market. In a subsequent stage, catching up and international growth were driven by asset-seeking acquisitions in the global market.

As we have already experienced, asset-seeking motivations are at the core of the recent theories proposing specific explanations of multinationals from emerging countries operating in developed markets in most recent years. These companies are expected to lack ex-ante monopolistic advantages, in particular as regards technology, patents and strong brands. A common hypothesis of these theories

is that emerging multinationals' FDI in industrialized countries may be explained not only by market-seeking drivers, but also by the need to access the resources and assets they lack. Their strategy is therefore oriented to augment or even to create, rather than to exploit, their specific ownership advantages (Balcet, Wang and Richet, 2017).

The Volvo takeover by Geely is thus an interesting case, showing the 'Chinese way' of catching up and investing in the EU, eventually becoming an emerging multinational.

In the late 1990s, a handful of domestic private companies accessed the Chinese automobile market and experienced rapid growth. Geely, Great Wall and BYD are the main examples. Without any experience of producing cars, Geely broke both industrial (technology, capital, managerial skills) and institutional barriers (government regulation limiting the number of OEMs) to access the automobile industry in the late 1990s. Geely's catch up efforts included technology imitation via reverse engineering, product architecture innovation and asset-seeking acquisitions abroad, together with various forms of international growth, including exports, assembly abroad, market-seeking operations and (again) asset-seeking acquisitions abroad. Having some previous experience in international cross-border acquisitions (in 2006 it acquired the British Manganese Bronze Holdings, London's leading taxi company and in 2009 the Australian auto parts maker Drivetrain Systems International), Geely in 2010 undertook the largest Chinese acquisition of a foreign carmaker by taking over 100 per cent of Volvo from Ford Motor Company for USD 1.8 billion. Since the acquisition, Geely has increased profits and sales volume and has been able to upgrade the quality of its cars in terms of safety, energy efficiency and environmental protection. Furthermore, it has filed about 1,200 patents (30 of which have been granted outside China) and is now among the top ten automobile producers in China and one of the top 500 Chinese companies (Balcet, Wang and Richet, 2017).

Since China's accession to the World Trade Organization (WTO) in 2001, the Chinese automotive industry as a whole has been booming. China thus became the largest automobile market in the world in 2009, with an average annual growth rate between 2000 and 2010 of around 35.84 per cent, reaching a sales volume of 18.26 million units in 2010. In the development of the Chinese automobile industry, foreign OEMs (Original Equipment Manufacturers) like Volvo have played a central role, bringing in technology, management know-how and marketing capabilities, as well as building distribution networks and supply chains.

3.3 Latest quantitative analysis of Chinese FDI in Europe

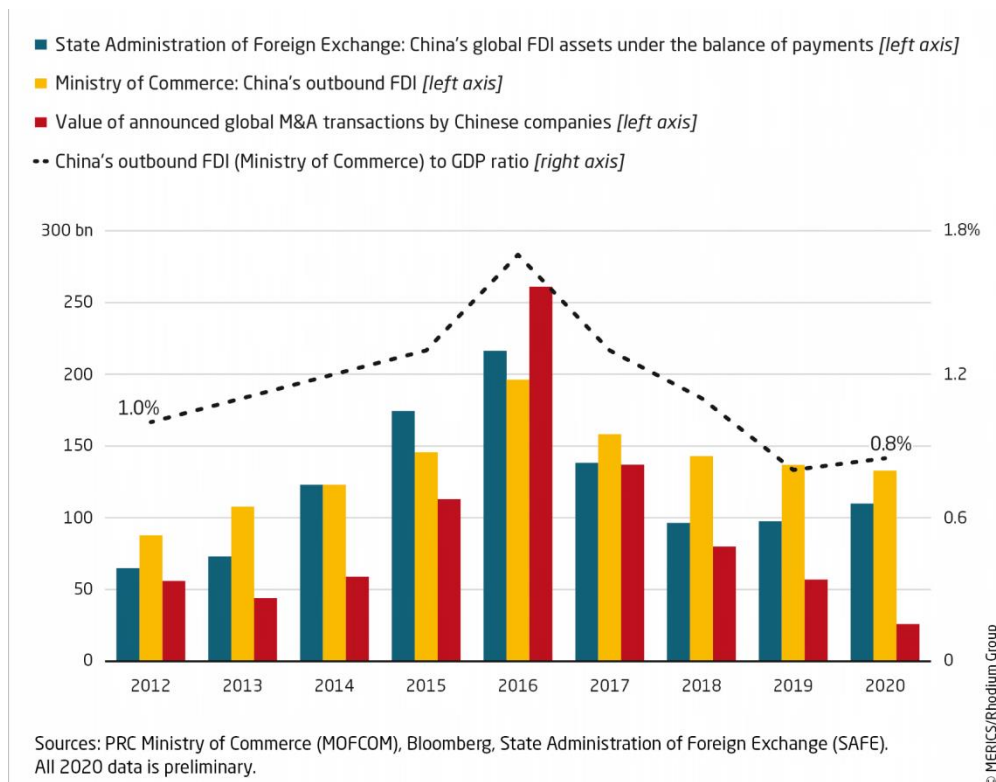
The Covid-19 pandemic has caused major global disruptions in business and social activities. Foreign direct investment has been no exception. According to the OECD, travel restrictions halted present

and new transactions, and the number of global FDI plummeted by 38 percent from the previous year in 2020, reaching the lowest level since 2005.

Fears emerged in Europe (and elsewhere) that Chinese investors might engage in buying distressed assets, taking advantage of depressed stock values around the world as the pandemic pushed countless countries into recession. However, there was no sign of an opportunistic buying rush. On the contrary, the global investment activities of Chinese firms declined in 2020.

Official Chinese statistics indicate stable outbound investment at \$132.9 billion, likely supported by intra-firm flows and arbitrage. However, transaction-level data paint a different picture. According to Kratz, Zenglein and Sebastian (2021), China's M&A activity fell to its lowest in 13 years in 2020, while completed deals totaled only 25 billion euros, down 45 percent from 47 billion euros in 2019.

Figure 3.6 – Official Chinese outbound FDI data, 2012-2020



Source: Kratz, Zenglein and Sebastian (2021)

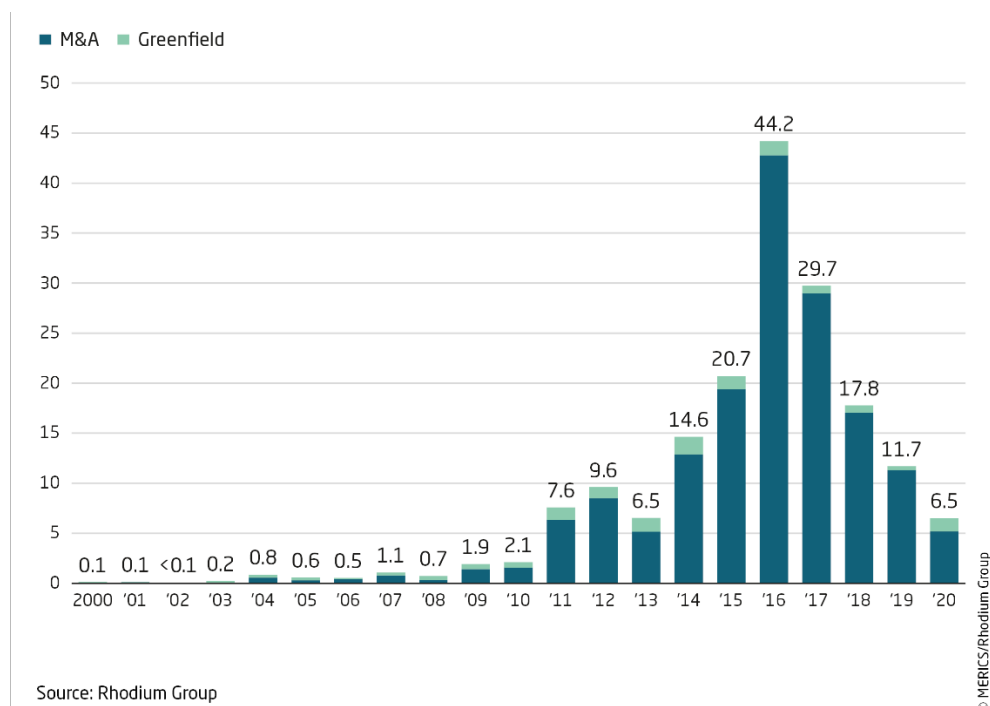
China's overseas investment activity has declined every year since 2016 due to domestic constraints on capital outflows and tighter control over Chinese overseas investment. The Covid-19 pandemic has exacerbated the decline in Chinese overseas activity, hampering normal business activity.

As a result of the pandemic, concluded Chinese FDI in the EU-27 and the UK fell to €6.5 billion in 2020, down from €11.7 billion the previous year (Figure 3.7). Facing a mix of travel restrictions and changed domestic economic circumstances, some Chinese investors finally decided not to complete

large transactions. For example, automotive giant FAW Group broke off negotiations to acquire Italian truck manufacturer Iveco for 2.6 billion euros, and Bank of China backed out of its purchase of Ireland-based Goodbody Stockbrokers for 132 million euros (Kratz, Zenglein and Sebastian, 2021).

In both cases, the Chinese side cited uncertainty related to Covid-19. However, as we will see, the pandemic was not the only force at play, as continued capital controls on outbound capital from China, intensified regulatory scrutiny of Chinese investment in Europe, and deteriorating public sentiment toward China created headwinds.

Figure 3.7 – Annual value of completed Chinese FDI in the EU and the UK, 2000-2020



Source: Kratz, Zenglein and Sebastian (2021)

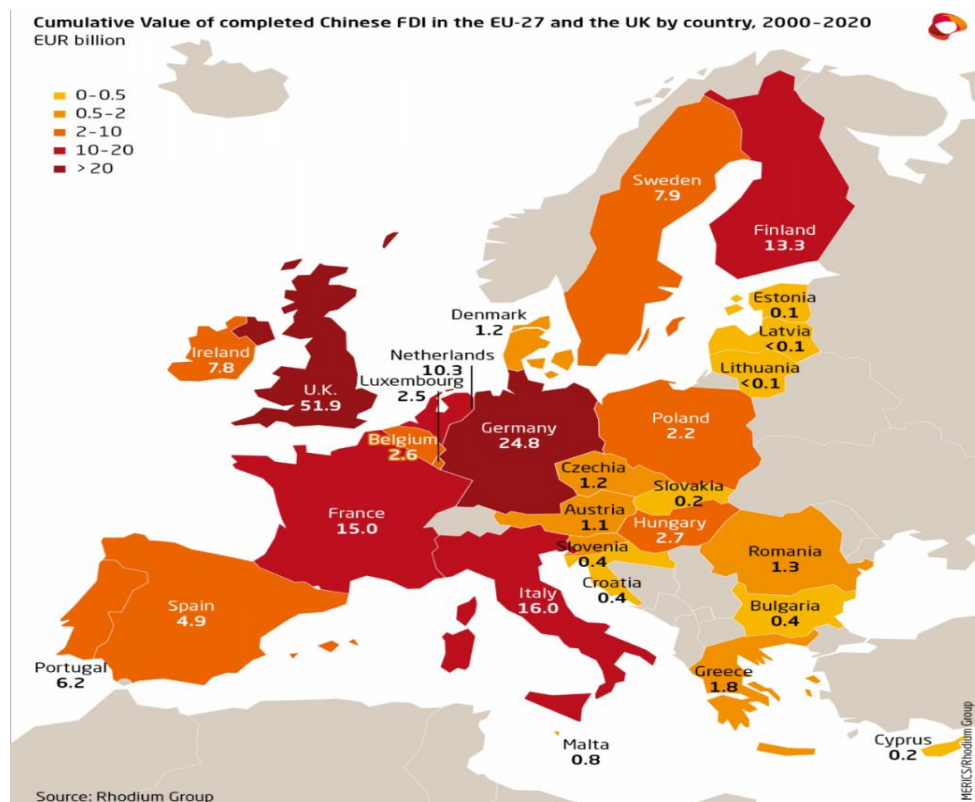
Declining M&A activity has caused total investment to fall. However, Chinese greenfield investment reached its highest level since 2016, at nearly 1.3 billion euros or 20 percent of total FDI, compared with an average of 6.5 percent over the past decade. Top greenfield investors include tech companies such as Huawei, Lenovo and Byte Dance, as well as consumer goods manufacturers like Haier and Hisense. Among the large multi-year greenfield projects announced last year, the most interesting were SVolt Energy Technology's €2.1 billion battery plant in Germany to produce electric vehicles, telecommunications giant Huawei's €1 billion investment in a research and development center in the United Kingdom, and a €438 million deal to build data centers in Ireland for TikTok, a subsidiary of Byte Dance (Kratz, Zenglein and Sebastian, 2021).

Europe's "big three" economies once again became the top destination for Chinese investment in 2020, receiving more than half of the total, and returning to more normal patterns after the high levels of transactions in the Northern European region (Baltic states, Scandinavia and Ireland) of the previous year. Germany was by far the largest recipient, most of which consisted of relatively small transactions. The United Kingdom, ranked third, experienced a 77 percent drop in Chinese inbound investment, the lowest level in a decade.

Poland rose to second overall, having attracted a record Chinese investment of 815 million euros, largely due to the Polish share of GLP's acquisition of the Goodman Group's Eastern European logistics portfolio. This deal propelled the whole Eastern European region to become the second favorite destination for Chinese investors in 2020, attracting a total of 1.5 billion euros.

Investment in the rest of Europe has been more evenly split due to the smaller average transaction size. Northern Europe's share of Chinese investments plummeted from 53 percent in 2019 to 11 percent in 2020 (with 703 million euros). Some major transactions occurred in this region, including Evergrande's acquisition of the remaining shares of Swedish electric vehicle manufacturer NEVS AB for €333 million. Southern Europe and the Benelux countries both saw a slight increase in their share of Chinese FDI: Southern Europe got 9.4 percent (598 million euros) and the Benelux region 3.3 percent (213 million euros) (Kratz, Zenglein and Sebastian, 2021).

Figure 3.8 – Cumulative value of completed Chinese FDI in EU-27 and the UK by country, 2000-2020

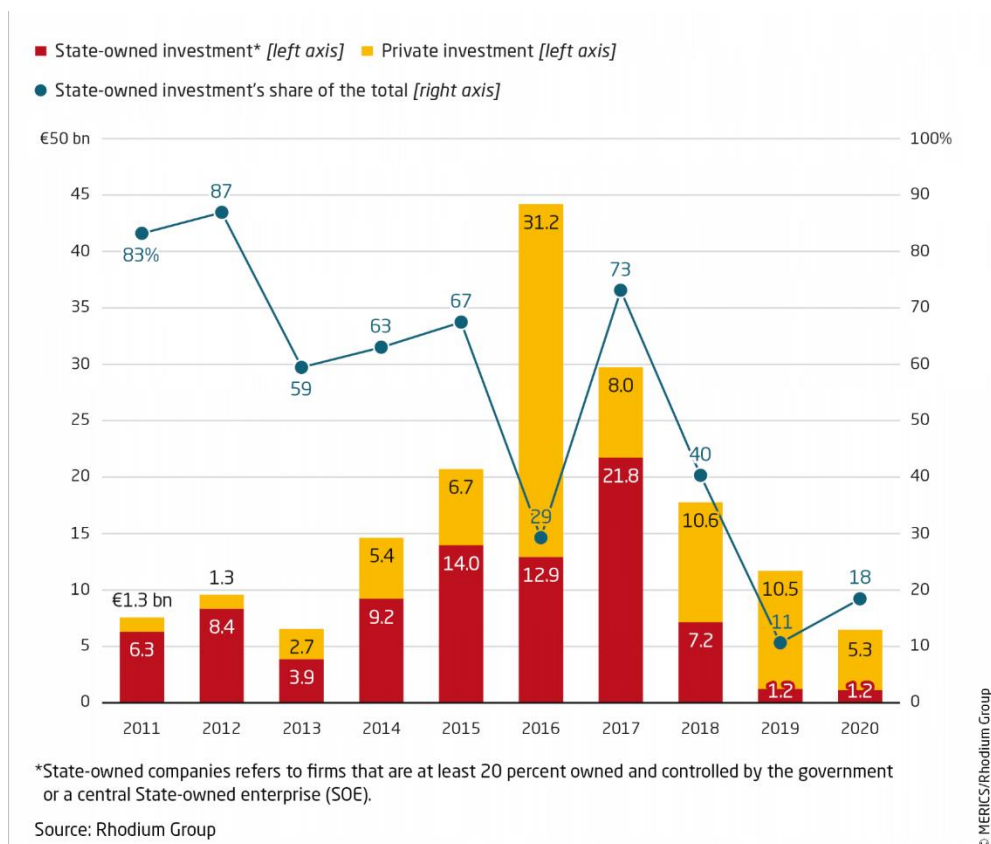


Source: Kratz, Zenglein and Sebastian (2021)

Historically, Chinese state-owned enterprises (SOEs) have made up for the majority of Chinese investments in Europe, averaging more than 70 percent of the total between 2010 and 2015. The private sector's share began to increase from 2014, thanks to the liberalization of China's foreign direct investment regime. Administrative controls have been relaxed and incentives for companies to invest abroad have increased. In 2019, European SOE investment fell to 11 percent of total Chinese investment.

In 2020, SOE investment remained stable in absolute terms at 1.2 billion (see Figure 3.9). However, private sector investment plummeted 49 percent to 5.3 billion euros, so SOEs ended up with a larger share (18 percent) of the total. Increased controls on Chinese state investment in Europe have not prevented Chinese SOEs from making major acquisitions in the transportation, energy and infrastructure sectors. China Three Gorges bought an additional stake in Portuguese energy supplier EDP for 229 million euros. China Railway Construction Corp (CRRC) acquired Spanish construction company Aldesa for 242 million euros. CRRC Zhuzhou acquired German railway company Vossloh Locomotive for 44 million euros (Kratz, Zenglein and Sebastian, 2021).

Figure 3.9 – Completed Chinese FDI in the EU-27 and the UK by investor type, 2011-2020



Source: Kratz, Zenglein and Sebastian (2021)

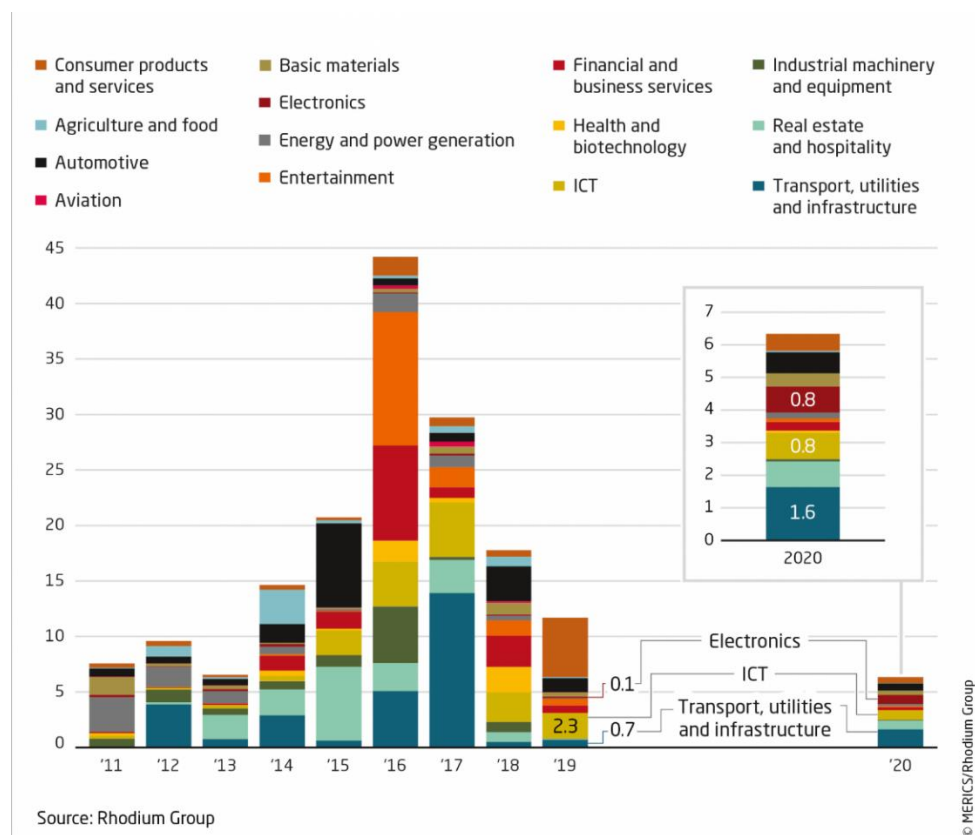
As we can see from Figure 3.10, in 2020 Chinese FDIs in Europe were more diversified than in the

previous year, when consumer products and services and ICT accounted for more than 70 percent. The more even distribution profile is mainly due to the smaller average size of Chinese investments. In 2020, the main target was the transportation, construction and infrastructure sector, with 25 percent of the total. The largest transaction was GLP's acquisition of the Goodman Group's portfolio of warehouses in Central and Eastern Europe, which included transactions in Poland, Slovakia, Hungary, and the Czech Republic totaling about 1 billion euros. Other high-value investments included CRCC's acquisition of construction company Aldesa for 243 million euros and China Three Gorges' purchase of an additional stake in energy supplier EDP for 229 million euros.

Nevertheless, the ICT sector remained popular, attracting 18 percent of the total. The striking feature of 2020 was the amount of ICT investment channeled into greenfield purchases; prime examples include Huawei's aforementioned R&D centers in the UK and Hungary, and ByteDance's TikTok data center in Ireland.

Electronics was the third largest sector by value of investment, and the transactions included the Universal Scientific Industrial's acquisition of the French Astelflash Group (395 million euros) and the Jiangsu Riying Electronics' acquisition of Elektromechanische Schaltsensoren EMS GmbH in Germany (171 million euros).

Figure 3.10 – Completed Chinese FDI in the EU-27 and the UK by industry, 2000-2020



Source: Kratz, Zenglein and Sebastian (2021)

3.4 Motivations of change of Chinese FDI policies in the EU

As previously witnessed, after a long period of steady growth, around 2016 the amount of Chinese FDI in the European continent slowed down sharply from close to 45 percent in the same year to 6.5 percent in 2020. The reasons for this sudden change can be found in multiple political, economic and social factors that have largely influenced the strategies of Europe and China in recent years.

First, we should keep in mind that since the mid-1990s China's economic growth has been particularly fast and marked by annual rates close to 10 percent. However, this trend has begun to fade since 2013, when the country's GDP growth rate began to decline to 6.1 percent in 2019, following pre-pandemic data from the National Bureau of Statistics of China.

This new situation of the Chinese economy stands to demonstrate a change in the economic growth model that President Xi Jinping and Prime Minister Li Keqiang themselves have referred to as the *new normal*: specifically, it is a slower and more sustainable growth model. China, thus, is moving to gradually change its economy: from a primarily export- and investment-driven system to an innovation-driven, service- and consumption-oriented economy. This transition requires structural changes and the formulation of long-term policies. During 2015, the Chinese government thus committed itself to promoting more initiatives that facilitate the country's transition to a high value-added economy, and that can solve problems such as overcapacity in factories, increase the productivity and global competitiveness of traditional Chinese industries, and promote innovation and entrepreneurship (Garcia-Herrero, 2021).

The key concept revolving around this historic shift is related to the so-called *dual circulation* strategy, which can be seen as an innovative representation of the Chinese economy as a product of the interaction between two dimensions: external circulation, so the interchange and flow of capital in and out, and internal circulation, focused instead on an increased attention on domestic consumption and production quality. The main goal is thus the development of a domestic market that can transform the country from its previous status of a territory devoted to exclusive production and export to a territory of domestic consumption in which Chinese society can play a key active role. In order to increase domestic demand, it is therefore considered necessary to provoke a capital circle within society and enable citizens to actively participate in the country's economy through the consumption of domestic goods. Moreover, it now seems clear that the reintroduction and subsequent internal development of imported know-how and technologies from specialized countries stands to mark a new beginning for the economic fabric of the Middle Kingdom.

This new growth strategy, dictated directly by the upper echelons of the People's Republic, is inevitably having a decisive impact on the flow of Chinese foreign direct investment to Europe and

the world. In fact, as we have seen, it is precisely the government itself that often gives the green light to its companies - more or less controlled - regarding the number of investments to be carried out in the respective sectors and countries of high national interest. Without that substantial slice of "state-driven" operations, which occupies a large part of the total share, it is therefore natural to see a contraction in the amount of FDI to Europe, even if for a small part offset by incentives aimed at promoting investments of private nature.

Another key word in this new Chinese normal is *decoupling*: the all-encompassing process of progressive separation between China and the United States due to the relocation of the production of U.S. companies out of the Middle Kingdom in sectors deemed strategic, preferably to other destinations, especially in Asia, or the United States (so-called *reshoring*). The best-known examples are those of Apple and Nike, which have moved their production lines to India and Vietnam respectively, but there are many U.S. companies, and others, that have already initiated this process of relocation. On the other hand, China, too, has long reduced its investments in the West, focusing more on its neighboring countries in Southeast Asia.

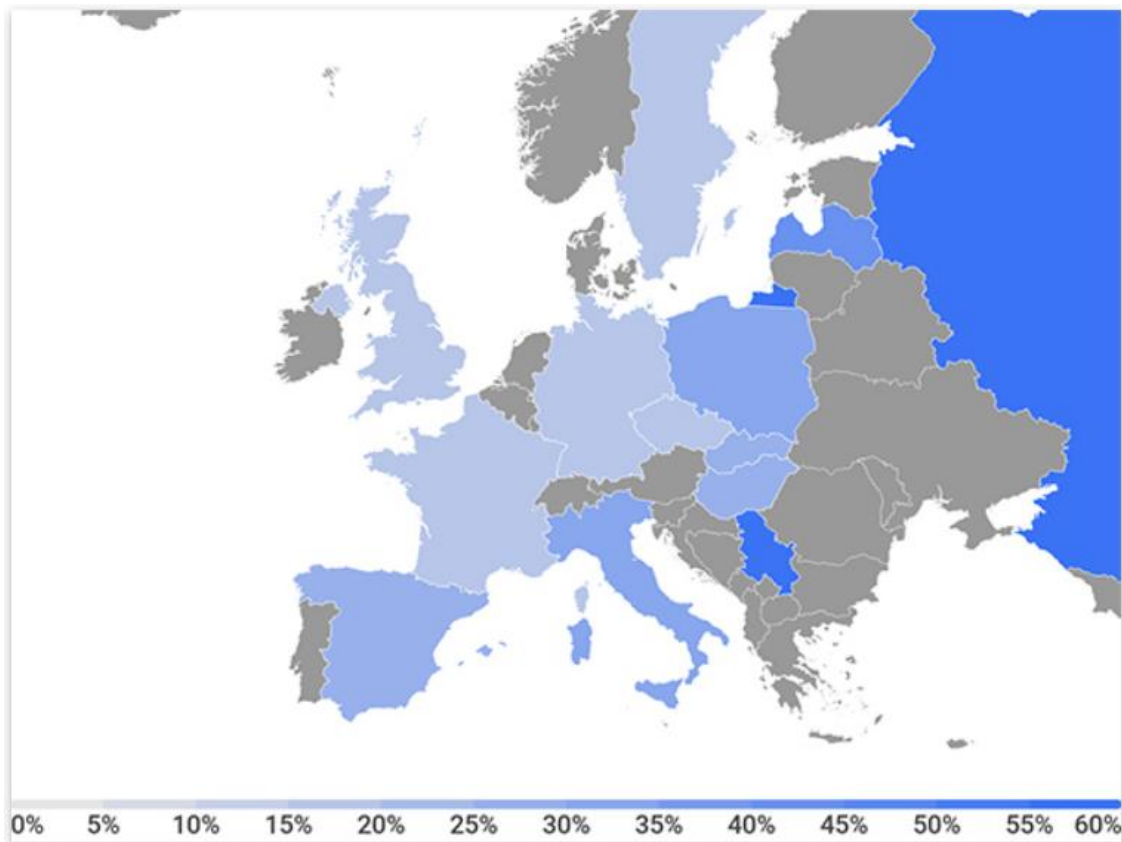
The trigger event was, in August 2018, former U.S. President Donald Trump's decision to impose 15 percent tariffs on some \$300 billion of products imported from China, to which China promptly responded by triggering a counter-package of tariffs between 5 percent and 10 percent on more than \$75 billion of U.S. products¹. As we all know, the subsequent outbreak of the pandemic first and the armed conflict between Russia and Ukraine later further worsened the situation, leading to a now palpable separation, once purely ideological, between the Western world, consisting of the United States and Europe, and the "rest of the world", mainly consisting of the China-Russia-India axis. Whether it is not possible to hazard concrete assumptions on what the future will bring to the table, the strategic nature of this dynamic leads us to consider it as structural, also leading to the inclusion of decoupling as a stable component of the actual global scenario.

An additional factor in the variation of the number of Chinese FDI in Europe can also be found in the recent increase, by several central administrations in the European Union, of the use of the so-called *golden power*, which can be defined as the regulatory instrument that empowers governments to place conditions or vetoes in case of "hostile" attempts by a foreign company to purchase a national company that is deemed strategic or active in a sector considered fundamental. Indeed, as we will see in the next section, whether this tool is actually empowered or not, it is undeniable that a growing phenomenon of foreign investment screening, especially concerning investments from China, is currently taking place in the Old Continent (Kratz, Zenglein and Sebastian, 2021).

¹ Il Sole 24 Ore (2021), *Cina, la grande fuga delle multinazionali dai dazi americani*, <https://www.ilsole24ore.com/art/cina-grande-fuga-multinazionali-dazi-americi-ACP3U0Z>

However, what most distinguishes the change in political and economic relations between China and the EU, and which can be said to encompass much of the above factors, is the overall change in the sentiment toward China itself. This is also evident in a 2020 report entitled "European public opinion on China in the age of Covid-19. Differences and common ground across the continent" and conducted by the Ceias, Central Europe Institute of Asian Studies. This study, which involved 13 European countries and was carried out on a representative sample of 1,500 people per country, shows a general negative trend. China tends to be viewed negatively by 10 out of 13 countries, with Northern Europe in particular revealing a very negative perception, and Southern European countries a perception that is also negative, but to a lesser degree. In particular, Sweden, Germany, France, the United Kingdom, and the Czech Republic are the countries that register a decidedly negative view towards the Asian giant, on the other hand Russia, Serbia have the most positive views, Latvia is the only EU country with a predominance of positive views. Needless to say, European public opinion about China has also significantly worsened after the advent of the Covid-19 pandemic, for which it is singled out as primarily accountable.

Figure 3.11 - Positive feelings towards China across European nations (% of respondents)



Source: Turcsányi, Šimalčík, Kironská, Sedláková, Čeněk, Findor and Summers (2020)

In the survey, an attempt was made to probe a wide range of elements, including concern for the

environment, development of 5G networks and human rights, to see which ones drive the perception. Of these, only trade is seen as positive, as many states have flourishing trade relations with the East Asian country, while the topic of Chinese investment in Europe is perceived with a mainly negative connotation, mainly related to the threat that these operations may lead to intellectual property thefts or damage the national socio-economic fabric. Regarding the latter, these overtly negative perceptions on the part of the European public opinion cannot help but be reflected politically and economically in protectionist movements aimed at blocking the Chinese acquisition of the respective "national champions".

3.5 Outlook of an ongoing change in China – EU investment scenario

In the first quarter of 2021, global M&A activity rose to 1.08 trillion euros, a ten year record. The jump was sustained by the broadening global economic resumption and the low cost of capital as a result of stimulus measures implemented by governments around the world. In fact, Chinese outward investment has remained depressed. In the first quarter of this year, China's outbound M&A activity stood at 2020 levels; the number of monthly transactions remained low, with about 20 individual deals. Within the whole European Union and the UK, the value of completed Chinese transactions continued to drop in the first quarter, leading to one of the lowest values in at least a decade (707 million euros).

According to Kratz, Zenglein and Sebastian (2021), low investment levels in early 2021 reflect several factors, all of which are likely to persist throughout the years:

Firstly, Beijing's tight capital controls continue to restrict Chinese FDI, despite the rapid economic recovery. The Chinese government has maintained a tight control on capital outflows, without being influenced by positive factors such as China's rapid and largely healthy economic recovery from the pandemic collapse, which brought strong capital inflows into China in late 2020 and the first quarter of 2021. This scenario could have given Beijing the confidence to list some of the current obstacles to outbound FDI. However, it has only limited itself to cautiously listing some restrictions, and in negligible ways. For example, quotas for outbound portfolio investment through the so-called "Qualified Domestic Institutional Investors" (QDII) were partially heightened; as a further example, the scope of Hong Kong southbound linkage mechanisms, which allow foreign investors to trade through the special administrative region's listed securities, was expanded. However, few actions have been taken to enhance outbound foreign direct investment. Moreover, most of the regulatory modifications were principally aimed at facilitating inflows rather than outflows. Access to capital

for is also limited many foreign investors, as China has changed its priorities from incentive to deleveraging and financial risk management.

Secondly, as previously mentioned the European Union has strengthened investment screening of Chinese investors, as an actual screening framework became fully active in 2020. Investment screening regimes have been revised by 14 countries since the beginning of the Covid-19 pandemic. For instance, the German government has already announced plans to expand investment screening rules to cover high-tech sectors, including artificial intelligence, semiconductors, autonomous driving and aerospace. In the short term, it is true that the new investment screening rules and their implementation may create some uncertainty for foreign investors until an implementation track record emerges. Transactions in sensitive sectors are more likely to be screened and potentially blocked. However, it is also true that more transparent and consistent screening rules can help reduce uncertainty in the long run and limit the politicization of some transactions. The approval of CRRC Zhuzhou's acquisition of Vossloh, despite strong public debate, is one example (Kratz, Zenglein and Sebastian, 2021).

In addition to FDI screening, Brussels is strengthening defensive measures against China's perceived distortions affecting the EU single market. Some of these measures could increase barriers to Chinese investment in the near future. On May 5th, 2021, the EU Commission published a proposal for an instrument that would give it the power to review and eventually block foreign investments that benefit from foreign subsidies. The EU also resumed work on the International Procurement Instrument (IPI), which could limit Chinese companies' participation in EU public procurement markets if European companies were restricted from participating in Chinese public tenders.

Lastly, as the relation between the European Union and China enter a new phase, the biggest risk to Chinese FDI in Europe is the tightening of political relations. In March, following EU sanctions against Chinese officials and government agencies for alleged human rights violations in Xinjiang, China retaliated with sanctions against EU individuals and research organizations. China's sanctions prompted the Members of the European Parliament (MEP) to pass a motion on May 2021 to freeze parliamentary ratification of the EU-China "Comprehensive Agreement on Investment" (CAI) - which will be discussed in the next chapter - unless sanctions are lifted (Kratz, Zenglein and Sebastian, 2021).

The adoption of the CAI is at the moment highly unlikely. Whatever the shortcomings of the CAI, failure to conclude it could lead to a slowdown in progress towards true reciprocity and erode public tolerance for Chinese FDI. Current political tensions could also be exacerbated by increased EU attention to South China Sea and Taiwan issues and the human rights situation in China. Experience has shown that it was the tightening of political relations, rather than FDI screening, that triggered a

drastic decline in Chinese investment in the United States. Tightening relations could become a key risk to Chinese investment in Europe in the future (Kratz, Zenglein and Sebastian, 2021).

CHAPTER 4

Challenges and opportunities: what to expect from the future?

Introduction

As demonstrated in previous chapters, the relationship between China and the European Union has been particularly volatile and uncertain in recent years, which has also had an obvious reflection on the mutual flow of foreign direct investment between the parties.

The purpose of this chapter is to analyze the three main opportunities for economic convergence - as well as the related challenges - between China and Europe, real crossroads in defining an increasingly interconnected and enduring relationship that, at least on paper, would bring substantial economic and systemic benefits to both parties. These opportunities, mostly plans and/or agreements still in an embryonic state or not yet ratified, are precisely derivatives of a recent past marked by a cautious approach of understanding and rapprochement regarding certain economic and business facilitation issues valued by both the Middle Country and the Old Continent. In this chapter, starting with "One Belt, One Road", the plan launched in 2013 directly by President of the People's Republic Xi Jinping and aimed at (re)creating the ancient trade corridor that linked the two continents, an attempt will be made - as far as possible considering its bilateral nature and current incompleteness - to focus attention on the role and consequences that these agreements will have on the flow of Chinese foreign investments to Europe.

In addition to "One Belt, One Road", this chapter also considers the EU-China "Comprehensive Agreement on Investment", namely the agreement, partly already approved by the European Commission but currently frozen, that would ratify for the first time down on paper the boundaries within which the two powers would balance their trade relations. Finally, the last focus of this chapter is on the correlation between the respective Chinese and European plans called "Made in China 2025" and "Industry 4.0," which are designed to restructure and enhance the respective industrial fabrics and that have already negatively influenced the relative balance of investments.

As already anticipated, in addition to the existing factors of divergence affecting relations between China and the European Union, the current global political-economic situation marked by the post-pandemic and the outbreak of the armed conflict between Ukraine and Russia adds further shades of uncertainty to an already complicated and mutable context. The likelihood of success - or even of

rediscussion - of the plans presented in this chapter appears, to date, increasingly remote and unpredictable. Nonetheless, for this very reason, I consider the mention of these issues important, as they are key representatives of a fundamental part of the relationship between China and Europe, as well as the starting point from which I believe we will begin to rewrite the history of these two powers, whatever it may be.

4.1 “One Belt, One Road”: the New Silk Road

For more than twenty years China's economic growth has been particularly sudden, as double digit growth rates were the norm. This trend, however, has been witnessing a steady slowdown since 2010, with the country's GDP growth rate declining to 6,1 percent in 2019, following data from the National Bureau of Statistics of China. This new situation of the Chinese economy demonstrates a change in the economic growth model, specifically involving a slower and more sustainable growth model. In fact, as we will see in the next paragraphs, China wants to implement the "Made in China 2025" strategy, which envisions a more sustainable and measured development and is based on the application of advanced technologies and increased efforts to transform the country from a producer of quantity to a producer of quality.

This transition involves the formulation of long-term policies and the implementation of structural changes. The Xi Jinping administration in 2013 began discussing a project, envisioned by the Beijing government, for increasing connections and cooperation in Eurasia. During a conference held at Astana's Nazarbayev University on September 7th, Xi extolled Kazakhstan's key role as a bridge between China, Russia, and Europe, saying that the country was ready to become an important strategic space again, as it had been in the past. On that occasion, the Chinese president proposed the idea of reviving the ancient Silk Road in order to strengthen trade ties and technological-industrial development in the Eurasian region and foster closer cooperation among the states in the area. Less than a month later, on October 3rd, at the ASEAN regional forum, during the speech given by the Chinese president before the Indonesian parliament, the proposal for a modern Silk Road was presented more explicitly, manifesting the full impressiveness of the project that the Chinese administration was intent on implementing. It was not only to rebuild a two-thousand-year-old land link, but also to create a maritime passage that would run from Southeast Asia to West Africa to the Northern Mediterranean Sea.

With this in mind, President Xi Jinping officially launched "One Belt, One Road" (一帶一路, *yī dài yī lù*) (hereinafter named OBOR), an ambitious project aimed at strengthening the projection of its foreign and trade policy not only regionally, but especially globally. This is done through a massive

program of investment, trade, telecommunications and infrastructure that is expected to engage a vast area and more than 60 countries, from Asia to Europe, from Oceania to East Africa. While this is precisely why there are numerous geopolitical, operational and financial challenges that the implementation of OBOR will face, at the same time the initiative represents a major opportunity for all the actors, state and private, involved in it. Through improved infrastructural connectivity, an open and balanced area of economic cooperation, characterized by cultural integration, can be created that will benefit all countries involved (Huang, 2016).

The infrastructural network aims to connect the East with the West again, through roads, railway lines, gas and oil pipelines, bridges, highways power grids, to date not present in certain areas of Central Asia, reviving trade activities on land and sea. All this will boost interregional cooperation, equipping countries along the Silk Road with the means to trade their resources.

This initiative encompasses two distinct transportation routes across Eurasia to enable the rapid transfer of people, goods and resources.

The Silk Road Economic Belt (SREB), also called the Land Silk Road, crosses all of Central Asia and reaches from China all the way to Spain, is aimed at uniting China, Central Asia, Russia and Europe. Specifically, China is planning a high-speed railway that will start in Kunming and expand to Laos, Cambodia, Malaysia, Myanmar, Singapore, Thailand and Vietnam. In addition, it is planned to create an additional network of roads, railways and pipelines that will start from Xi'an and wind westward toward Belgium. The ambition is to build four of the six corridors overland: the New Eurasian Land Bridge, a project to expand rail links between East Asia and Europe; three connecting belts-China, Mongolia and Russia; China, Central Asia and West Asia; and China and the Indochinese Peninsula.

The Maritime Silk Road (MSR) is divided into two routes, one that runs from China through the Indian Ocean, the Red Sea and finally connects to Europe, and the other that connects Beijing with the Pacific islands across the China Sea.

Figure 4.1 – China's Belt and Road Initiative



Source: <https://www.policymakermag.it/italia/nuova-via-della-seta-roma-timori-usa/>

In addition to physical connections through infrastructure construction, OBOR project aims to create an area of political and economic cooperation in which China is the main actor. We can list the main objectives of this majestic project with the following points:

- increase and make efficient trade between China and European countries;
- access to and diversify sources of energy supply;
- expand Chinese political and economic influence;
- make China the new "center country" replacing the U.S. as the new global player;
- export Chinese manufacturing overcapacity.

In fact, the expansion of Chinese companies into OBOR-involved territories has been and will continue to be driven by different strategic motivations: natural resource seeking, in reference to China's interest, which has always been lacking in natural resources, in resource-rich countries such as oil and gas, which include Russia, Central Asia, Africa, and the Middle East, where China, for example, has engaged in the construction of oil and gas pipelines; market seeking, in terms of

facilitating trade, willingness to develop foreign markets, and also to strengthen the regional economic integration of Chinese enterprises, such as FDI made in ASEAN countries; efficiency seeking, especially with regard to Southeast Asian and South Asian countries where labor and input costs are very low; and finally strategic asset seeking, with regard to China's interest in the developed countries of Europe.

Although the project is still being implemented, China has started to carry out its first FDI under the impetus of the new Silk Road: as stated by MOFCOM (2016a), the countries covered by the OBOR initiative have already become important destinations for Chinese FDI. In 2015, Chinese firms invested in 49 of these countries with a total value of \$14.82 billion. Specifically, they invested \$11.46 billion in the transportation, power and communications sectors. In addition, Chinese enterprises promoted the establishment of 75 economic cooperation zones.

As noted in the Vision and Actions on Jointly Building Belt and Road (NDRC 2015), Chinese firms have a primary role in project implementation and have been encouraged to invest especially in infrastructure construction, transportation, energy, and telecommunications in the countries covered by the initiative to especially improve the connectivity of the Asian region, as most of these countries lack an adequate infrastructure network. As the project grows in size, new markets should be created for Chinese companies with major positive spillovers within the country itself, in fact, it is expected that the project can be a solution to the country's overcapacity problem and can give a strong boost to the internationalization of the Chinese currency (RMB).

Improved infrastructural connectivity will facilitate companies' access to certain markets and stimulate China's outbound FDI in the various countries involved in the OBOR, not only in infrastructure, but also in others. We also need to consider the other reasons why the country is interested in these areas, such as China's growing interest in the developed countries of Europe, where Chinese companies, for example, want to put more effort into strategic asset seeking FDI, to acquire access to advanced technology and other assets, which the country needs to continue its economic transition. Moreover, as China wants to gain a better position in the global value chain, Chinese firms will seek to locate parts of supply chains along the OBOR countries so as to exploit their comparative advantages and make high-quality products at a low cost (KPMG 2016b).

From a geopolitical point of view, the Chinese project will have important implications, especially in relation to the primary position China would assume globally if the initiative were actually completed. Indeed, it seems that OBOR goes beyond improving the infrastructure network: China aims first and foremost to maintain stable cooperative relations with neighboring countries so as to tie them more closely to its economy and exert a strong influence on the weak and poor areas around it. In particular, Chinese authorities want to have greater influence in strategic areas such as Central Asia and the

Middle East (Nataraj, Sekhani 2015; Rolland 2015).

The New Silk Road project is still being implemented, and as we have seen, in recent years the Chinese government has been working to promote the initiative more, and under this push, Chinese companies have become increasingly involved in the project countries by carrying out FDI.

Considering the size of the project, it will take China a long time to complete it, although the country plans to conclude it in 2049, which is the centenary of the founding of the People's Republic of China (Nataraj, Sekhani 2015).

However, the success of the project will depend on how China manages the obstacles presented by the new Silk Road. First and foremost, the country must consider that plans to upgrade and improve communication and infrastructure in the countries involved may present obstacles related to the physical conditions of the natural environment, which in some cases are particularly hostile, and to relations with the various local governments. In reference to this, it is enough to consider Sri Lanka's democratic turnaround that stopped the involvement of Chinese companies in Colombo in 2015 or, for what concerns the EU, and only considering the pre-pandemic era, the increasing skepticism toward the final goals and the balancing of powers stemming from the entire project. Moreover, the absence of powers such as the United States and Japan, desired by China, is of particular relevance as the two countries could not only provide needed funds, but also act in order to jeopardize the whole initiative (Rolland, 2015).

In addition, China will have to make major diplomatic efforts as it is involved in numerous territorial sovereignty disputes, especially in the South China Sea, with countries such as Brunei, Cambodia, Indonesia, Malaysia, the Philippines, Singapore and Vietnam. In addition to these, China has major border disagreements with Russia and India. In particular, it must seek to manage these disputes and improve relations with these countries to increase cooperation (Devonshire Ellis, 2015).

Finally, the lack of an official authoritative map and the absence of clarity, especially on the exact details of the proposed economic corridor projects, has led some commentators to conclude that the OBOR project is nothing more than an "ill-defined mirage", or an empty shell that has generated much noise but will produce few concrete results (Rolland, 2017).

Regardless of the perceived motivations and drivers, many Western commentators believe that the OBOR initiative will most likely not happen anyway. Its size and ambitions multiply the number of difficult challenges, ranging from standardizing rail gauges to potentially weakening China's ability to finance projects because of its own economic difficulties.

4.2 EU - China “Comprehensive Agreement on Investment”: a reciprocal rapprochement

On December 30th, 2020, after 7 years and 35 rounds of negotiations the European Union and the People's Republic of China reached a major investment agreement. The signing of the so-called Comprehensive Agreement on Investment (CAI) took place on the 45th anniversary of the establishment of diplomatic relations between China and the EU. Nevertheless, this is not the end of the process that requires actual signing by China and the EU and ratification by the European Parliament. According to the text, “the two Parties will endeavor to complete such negotiations within two years of the signature of this agreement”². However, given the present situation, at the moment there seem to be no intention to finalize the agreement any time soon.

The announcement of the agreement sparked intense debate. The CAI found supporters as well as opponents in Europe. It was hailed as a highly beneficial agreement for world trade by China and as a breakthrough in controlling China's hitherto openness and its concessions on market access, level playing field and sustainable development were considered a success by the European Commission, but met with harsh criticism from the United States, which saw it as a victory for China in its attempt to divide transatlantic allies (Casarini and Otero-Iglesias, 2021).

According to the analysis of Godement (2021), the above-mentioned concessions constitute the main pillars of the CAI: *market access* (sectoral openings and conditions for foreign employees), *level playing field* (including disciplines particularly on technology transfers, SOEs' transparency status for subsidies), and *sustainable development* (corporate social responsibility, labor and environmental standards). Missing so far is the chapter on investment protection, which should have been completed within a year after the signing of the CAI.

The first pillar, or *market access* component, lists manufacturing sectors open to European investment - a positive list that includes sectors ranging, for example, from agricultural processing to clothing and paper. This is largely a confirmation of previous openings by China, both under the auspices of the WTO and through the subsequent publication of several "negative lists" for foreign investment: these have been published since 2014 for Special Economic Zones (SEZs) and transformed into national lists. New concessions for European companies are much more limited: biological research (except stem cells and genetics), health clinics in eight Chinese cities and Hainan, assembly of electric cars, cloud services, and some telecommunication services. Even these concessions are often

² European Commission (2020). *EU-China agreement in principle*. https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china/eu-china-agreement/eu-china-agreement-principle_en

constrained by planning considerations on the part of the Chinese government. In the other direction, the main Chinese win is the right to invest in renewable energy production to the tune of 5 percent, even if the so-called temporary caps are set much lower and seem to reflect an expectation of reciprocity. Regarding the use of foreign labor, the concessions can be considered a victory for China. Residency and work permits are granted for up to 3 years to managers and "specialists" working locally for a foreign investor. Although difficulties with visas and work permits are a major problem for European and foreign investors in China, the reciprocity granted to Chinese employees - even if their contract must comply with local regulations - is remarkable.

According to Godement (2021), the agreement is also a reassurance from Europe that investment remains open. This is clearly a plus for China, which practices some economic decoupling under the guise of a "dual circulation" economy but fears more restrictions from its partners. However, the reassurance does not include the sectors covered by investment screening for security reasons, a reservation largely met by China's 2019 Foreign Investment Law, which defines in broad and general terms the sectors for which transactions can be blocked. More generally, both sides have reserved the right to create new laws affecting foreign investment, as long as they are in "good faith" and do not serve to cover up protective measures.

This last point means, of course, that neither side has lost policy space, and this was a goal of the EU, which does not create informal barriers beyond the law. Overall, the benefits for European investment market access appear to be minimal, but they cannot be described as negative either. They are largely concentrated in services, because investment in manufacturing and non-services remains much less covered than trade by the WTO agreements. The agreement is also limited to local entry and operation: cross-border investment and services are not covered by the agreement.

The second pillar of the CAI concerns the creation of a *level playing field* in many areas. This goal falls under several headings. According to the Commission's summary, "in addition to rules against forced technology transfer, the CAI will also be the first agreement to include obligations for the behavior of state-owned enterprises, comprehensive rules for transparency on subsidies, and commitments related to sustainable development"³.

Among the improvements, three areas are likely to stand out. One is the so-called binding and reversal clause. The first term prevents China from revoking concessions. The second forces China to mutualize successive concessions to another partner: this is in effect the most-favored-nation (MFN) rule. It is worth noting that it does not prevent China (or the EU) from establishing new regulations and applies only to services, excluding the manufacturing and standards (environment, labor) sectors

³ *Ibidem*

that fall under sustainable development. It is thus the literal implementation of WTO rules, even with their broad limitations.

Another improvement is that of national treatment, which under WTO rules is mandatory for goods but not for services. This affects the behavior of state-owned enterprises, which are not allowed, except in their public role, to discriminate in the purchase or sale of services. A broad definition of SOEs, along with a requirement to provide information on them, will fill a gap, and it is also important because of the hybrid nature of China's economy and the move toward even greater control of private companies from 2017 (Godement, 2021).

However, to the leveling of the playing field described above, there are important exceptions. Not included are government services and procurement, news organizations, social services, education and health care. European negotiators did not accept Chinese requests to exempt infrastructure investments in Europe and most of the energy sector from screening.

Overall, the concessions obtained by the European Union on investment appear more significant in principle than those on sectoral openings. Moreover, they are not matched by a very broad European offer. Investment screening and future legislation, including anti-subsidy competition rules applicable to non-European investors, have not been waived, hindering the basic principles of liberalization and mutual openness that are at the core of the agreement.

Finally, the terms related to *sustainable development* have often been criticized by the European media and civil society. They include provisions on labor, climate and corporate social responsibility. There is a commitment not to lower standards and rules in order to attract investment or to prevent it. It must be acknowledged that within the CAI, China has made new international commitments, specifically that "each Party will make sustained and continuing efforts on its own initiative to pursue ratification of fundamental International Labor Organization (ILO) conventions No. 29 and 105, if it has not already ratified them"⁴: this includes the issue of forced labor. But the mention of "on its own initiative" and the absence of a deadline seem to weaken the commitment. However, as stated by Godement (2021), at least CAI has the merit of officially opening the conversation.

The other area that has stirred controversy is arbitration and dispute enforcement. Critics have focused on the process that applies to issues under sustainable development. Here, the dispute resolution process is much weaker than the provisions established in other areas. The agreement cites general statements or agendas of the UN, ILO or OECD, rather than specific rules or conventions. Even with partners like Japan or Korea - full democracies based on the rule of law - the commitment to "work for," "make efforts" to ratify any ILO convention is not binding. This is because the "new generation" trade and investment treaties that deal with labor, the environment and sustainable development, for

⁴ *Ibidem*

the most part, are not subject to WTO enforcement or legal recourse. To date, trade rules are still not mixed with legal rules. At most, these are subject to a bilateral arbitration process, usually without sanctions unless specified. In this case, there are arbitration hearings, understood to be transparent when no confidential data are involved. But there is no appeal, no sanction, and no enforcement mechanism. Inevitably, this and the Xinjiang issue - which in fact overlap - will have to be debated in the European Parliament. From a geopolitical rather than purely economic perspective, the high-level dialogue initiated by the CAI between the EU and China should lead to a resolution of this issue. For its part, although China has hailed the agreement as a breakthrough and a sign of Europe's willingness to chart its own course toward China, other experts have argued that the negotiation may have conceded too much to Europe and said that it was a generous gesture at a time when Europe is suffering from a pandemic and related economic difficulties. According to Godement (2021), this assessment overlooks the fact that the purpose of negotiating an investment agreement was to remedy a situation where rules and restrictions are much stricter in China than in the European Union: the starting points were a developing and statist economy on the one hand and a set of developed market economies on the other. But there may be some truth in this estimate by some Chinese experts.

Regardless of the criticism in Europe about the shortcomings of the agreement, it remains easy for China to forego the benefits and commitments it has made.

The CAI is currently frozen due to disagreements over the situation in Xinjiang, but the debate on it is far from over. On May 20th, 2021, the European Parliament voted to suspend its ratification. The move came after Beijing imposed retaliatory measures against members of the European Parliament for their support of sanctions against Beijing for oppressing the people of Xinjiang. The Chinese sanctions imposed in March 2021 on several European bodies and political representatives, including five members of the European Parliament and the Subcommittee on Human Rights, were an act of retaliation in response to the EU's decision to take restrictive measures against four Chinese officials for human rights violations against the Uighur Muslim minority in the Xinjiang region (Casarini and Otero-Iglesias, 2021).

The European Parliament's decision to freeze the CAI reflects the growing disagreement in recent years with China among European lawmakers who, because of sanctions, are determined to oppose Beijing more firmly. However, China remains Europe's second-largest trading partner and a vital engine of global growth, and any move against Beijing could open the door to an escalation of economic retaliation, a prospect that could limit the extent to which European governments and the European Commission are willing to move forward to pressure China. In fact, it is very likely that some EU governments will try to resurrect the CAI, as many industry associations in Europe support the agreement, seeing it as an opportunity for European companies to enter and/or gain increasing

shares of the Chinese market.

4.3 “Made in China 2025” vs. “Industry 4.0”: the world-leading innovation challenge

As anticipated earlier, the *Made in China 2025* (中国制造2025, zhōngguó zhìzào 2025) plan is linked to the qualitative growth of China’s manufacturing. In fact, it is an industrial policy launched in May 2015 by the Chinese government aimed at transforming the country's entire industrial fabric, and includes the development and integration of new materials and technologies with very high added value, such as robotics, the Internet of Things (IoT), added manufacturing, and cybersecurity.

Indeed, this is an extremely complex challenge for China. As pointed out by Gabusi and Prodi (2017), in fact, China's gross domestic product (GDP) is still very dependent on the manufacturing sector, and the acceleration of the technology transition that has hit this sector comes at a time when the country's growth is slowing down. In a recent report published by the European Chamber of Commerce in China (CCEC), it is recalled how 25 percent of the value added produced in manufacturing globally is "Made in China", that is: 28 percent of automobiles, 41 percent of ships, more than 80 percent of computers, more than 90 percent of cell phones, 60 percent of color TVs and half of global steel. Moreover, for China it is also facing a much more complex leap in innovation than what more advanced countries are already experiencing, as it still has in place many production chains structured to take advantage of the low cost of Chinese labor.

On the other hand, there seems to be no alternative. Labor costs in China have been rising in recent years at the rate of 10 percent per year, and the projected aging of the population in the coming decades will only increase the trend of depletion of the pool of cheap labor whose exploitation has enabled China's economic takeoff. China must therefore change its development model to remain competitive and also to be able to capture a greater share of the value added created by its manufacturing enterprises. This is only possible if they control the crucial links in value chains, entering downstream into distribution, but also becoming more innovative upstream (Gabusi and Prodi, 2017).

Made in China 2025 (MiC-25) is part of the answers to these problems. Covering the 10-year period from 2016 to 2025, and with targets set for both 2020 and 2025, the MiC-25 initiative is the first of a three-step plan to establish China as a leading global manufacturing power by 2049, the 100th anniversary of the founding of the People's Republic of China. The initiative aims to achieve this goal by addressing the fact that China's manufacturing industry is currently large without being strong,

due to a continuing lack of internationally competitive companies and products of its own, as well as dependence on foreign companies for many basic technologies and classes of capital equipment. It also recognizes that as the days of double-digit growth in manufacturing output are over due to the inefficiency of traditional methods and lack of high-end production, the country needs to improve the quality of its industrial base.

Conversely, the origin of the term *Industry 4.0* dates back to 2011, when Henning Kargemann, Wolf Dieter Lukas and Wolfgang Wahlster first used it in a communication held at the Hannover Fair, in Germany, whereas in 2013 the final report was finally presented. The plan is aimed at modernizing the German production system and enhancing the competitiveness of its manufacturing, and the suffix 4.0 refers to the fourth phase in the history of industrialization, characterized by the following sequence:

- **Industry 1.0** or first industrial revolution (1784). It originated with the birth of the steam engine, which enabled factories to abandon mills and begin the mechanization of production by harnessing the energy of water and steam;
- **Industry 2.0** or second industrial revolution (1870). Electricity and oil were introduced as new energy sources in this second phase, increasing the level of mechanization. The high power achieved enabled the introduction of the assembly line and the start of mass production;
- **Industry 3.0** or third industrial revolution (1970). At this stage, thanks to the introduction of information technology and electronics, a digital transformation of the factory is achieved;
- **Industry 4.0** or fourth industrial revolution (2011). The challenge of this revolution is to bring automated and interconnected industrial production to life through the combination of multiple technologies, called enabling technologies.

Although finding a shared definition of the term is not possible, one of the best known is the one developed by the European Commission, which defines Industry 4.0 as “that process of merging digital technology and the Internet with conventional manufacturing”⁵.

Germany's achievements have led other European countries, including France, the Netherlands, Sweden, Denmark and Italy to pursue this course of action, and the term Industry 4.0 has become internationally known.

Clearly, MiC-25 cannot be defined as a mere rehash of Industry 4.0 projects developed in Europe. Industry 4.0 is about technological advancement, while MiC-25 is about restructuring the entire

⁵ European Union Chamber of Commerce in China (2022), *Annual report 2021*, [https://european-chamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/Annual_Report_2021\[975\].pdf](https://european-chamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/Annual_Report_2021[975].pdf)

industry and making it more competitive using advancement in production technology as just one of the instruments. In other words, Industry 4.0 is only one part of the Chinese strategy. In fact, while the technologies being considered are indeed the same, different is the industrial policy that supports them, develops them and implements them. As is the case with all Chinese economic policies, Made in China 2025 has a predominantly top-down approach. The government details not only the technologies, but also the main areas of focus: next-generation information technology, high-tech numerical control machines, robotics, aerospace and aviation, advanced equipment for maritime and railway engineering, high-tech ship production, energy-efficient and electric vehicles, agricultural machinery and equipment, new materials, biopharmaceuticals, and high-performance medical instruments. The plan also defines what the goals are: from reducing costs, to increasing quality and reliability, to establishing new innovation centers, to the percentages of components to be produced in the country. Finally, it defines the tools needed to achieve the stated goals. The aforementioned CCEC report points to ten of them: forced technology transfers in exchange for market access, restrictions on market access and government procurement for enterprises with foreign capital, adoption of specific standards, handouts of subsidies, financial policy, government-guaranteed investment funds, support from local governments, foreign investment in search of technology, merger and politicization of SOEs, and public-private partnerships.

Unlike the top-down approach often taken by the Chinese government, the EU does not consider massive provision of government funding and subsidies to support the sale of products to be an effective policy tool. For example, in the German government's action plan, only €200 million has been allocated for Industry 4.0, while individual representatives of numerous industries have pledged to spend €2.5 billion in six areas over the 10-year life of the project. Unlike China, the initiative only provides support in the form of R&D tax credits, with no subsidies for the production or sale of products (CCEC, 2017).

MiC-25 thus aims not only to promote the adoption of new technologies but also, and more importantly, the capacity for their development. An early version of the MiC-25 documents had gone so far as to indicate the percentage of components for each production sector that would be produced in the country. Subsequently, the government denied that the stated targets had been defined by itself. However, the idea that there are definite targets cannot be questioned, and the fact that the government has denied setting specific targets should come as no surprise. These targets, which are very high, would be hardly compatible with the rules of the World Trade Organization.

To achieve the goals it has set, the Chinese government is not only relying on innovation developed by national companies and research centers but is also turning to foreign companies that are, to date, more advanced in various fields. We have already had several examples of this in recent years, from

Syngenta, a Swiss multinational company and one of the world's leading seed and agricultural chemical manufacturers being acquired by ChemChina, to Germany's Kuka, Europe's leading manufacturer of industrial robots, being acquired by Midea, a Chinese appliance manufacturer, for 4.5 billion euros.

Finally, as pointed out by Gabusi and Prodi (2017), the instruments used to implement these policies create several concerns for European companies, too. On closer inspection, these are not new instruments, as each of them has been used for many years formally or informally. As a matter of fact, foreign companies have always complained about the more or less explicit demand coming from the Chinese government - central or local depending on the importance of the enterprises - for them to move more sophisticated production into the country and to sell the most advanced products outside the country. Similarly, local enterprises have always had privileged access to the government procurement sector, nor is new the use of subsidies to companies that not only want to innovate but also simply export. However, seeing all these instruments formalized together can only be worrying, all the more so since the hope - until at least some time ago - was that of a reduction in state intervention in the economy and a level-playing field related to the ease of doing business with and within China's economic environment.

For many European companies operating in the sectors covered by MiC-25, market access has thus become increasingly difficult. This is because Chinese firms have closed the gap through technology transfers from foreign companies partnering with joint ventures and/or acquisitions, improvements to their domestic R&D activities, or simply because they enjoy preferential access to China's large domestic market, options that European enterprises are not able to pursue.

Conclusion

FDI from China, as we have seen, has been increasing almost steadily over time for decades, until a sudden halt in recent times, when the flow of investment suffered a major, and still ongoing, setback. Notably, we also checked how institutional theory is the best explanation for the emergence of Chinese FDI in the international investment landscape and for its development over time. Indeed, we have observed how the scale of FDI carried out by Chinese firms has gone hand in hand with the policies on economic matters developed by the government and thus with its goals and objectives. In this regard, it is enough to consider the increases in FDI that have occurred as a result of the formulation of the country's policies on opening up to the foreign world such as the "Open Door" policy and, above all, the "Go Global" policy and those related to the relaxation of FDI approval and monitoring procedures.

It should also be remembered that even under these instruments of openness and liberalization, Chinese enterprises have always been pushed to invest in key sectors for domestic economic development, such as, for example, natural resource seeking investments to meet the country's growing energy needs.

We should similarly consider the recent increase in Chinese FDI that has occurred in developed countries, which appears to be motivated by China's need to gain access to certain technologies that underpin the economic transition the country is attempting to complete.

China has also encouraged its enterprises to internationalize in order to create economic players that can compete with the large multinational corporations, which have already established themselves as such on the world stage and are predominantly from developed countries, in order to gain an increasingly important role. Chinese enterprises have been able to achieve a prominent global position mainly due to the support and encouragement provided to them by the government, their ability to invest while lacking strong competitive advantages, acquiring key knowledge from foreign partners, and effectively carrying out FDI in developed and undeveloped countries.

Of the largest Chinese firms that have undertaken international activities, most are state-owned companies or, at any rate, those very close to government circles. FDI policies, as we have seen, while allowing privately owned enterprises to make investments abroad, have also always favored and supported state-owned companies.

Moreover, the analysis conducted in the paper shows how the importance of China's role as a source of foreign direct investment in Europe grew steadily from the early years of the new century until 2016, undergoing in particular a major acceleration between 2007 and 2008 following the global financial crisis that opened up enormous profit opportunities for Chinese multinationals arising

mainly from the acquisition of European firms. In fact, as we noted in the paper, it is precisely mergers and acquisitions that account for the overwhelming majority of Chinese FDI in Europe, with greenfield investments taking a back seat. This rapid rise of Chinese FDI in Europe can also be explained by the realization of the importance that FDI can take on in promoting national development by the Chinese government, which through various initiatives has increasingly sought to open up to this type of investment by fostering a climate of private liberalization. We then noted how these peculiar investments from an emerging country to a developed region such as Europe are mainly dictated by the search for (and acquisition of) Western technological and managerial know-how as well as the desire to access new outlet markets where to sell their products. From the analysis it is then possible to see how Chinese FDI in Europe is indeed concentrated mainly in the "Big Three" countries (France, Germany and the United Kingdom) but how, especially in recent years, the other European countries have also grown in importance as receptacles of Chinese investment. Finally, the differences in the industries of destination of these investments are becoming increasingly thinner compared to past years, when they were mostly concentrated in manufacturing, heavy industry, and the infrastructure sector.

Furthermore, through the analysis conducted in the paper, we then examined the multiple factors that have recently led China to vary the amount of investment destined to the European continent. In fact, as we have seen, for the past five years the percentages related to this type of operations have been falling dramatically, more than 35 percent. The reasons for this decline are varied and involve both internal factors within China itself, such as the recent tightening of the screening process regarding outbound FDI decided by the Beijing government, and external factors, such as the advent of the Covid-19 pandemic and the outbreak of the armed conflict between Russia and Ukraine. The latter, however, while being factors of fundamental importance in the current context of political and economic estrangement between China and Europe, turn out to be mere amplifiers of a far more complex process.

First and foremost, in fact, the decline in the number of outbound foreign direct investment from China is partly due to a radical structural change that is currently affecting the entire Chinese economic fabric, the focus of which is gradually shifting from a primarily export- and investment-driven system to an innovation-driven, service- and consumption-oriented economy. This so-called Chinese *new normal*, which is more focused on building a quality domestic market and is directly sponsored by the Communist Party upper echelons, has obviously adversely affected the previous foreign projection of China investment, which, as noted previously, has always been closely linked to central government decisions. A strong link with this new context of China's domestic development is also represented by the "Made in China 2025" plan, the first of a three-step plan to establish China

as a leading global manufacturing power by 2049, the 100th anniversary of the founding of the People's Republic. Indeed, the fundamentals of this massive plan, so the internal development and integration of new high value-added materials and technologies in order to take the entire manufacturing model to the next level, appears to be in great contrast with the previous Chinese policies related to FDIs.

Another major factor of disruption contributing to the sharp fall in the outflow of Chinese FDI in the EU revolves around the concept of *decoupling*, or the process of progressive economic, technological and financial separation that involves both the USA and China, started in 2018 with the trade war and still more than present nowadays. In fact, as we have seen, this process is also having important repercussions on the mutual relations between the Asian giant itself and Europe, which is in turn gradually tightening its policies of general openness to investments from the Middle Kingdom. The increased use of foreign investment control instruments - such as *golden power* - in various EU states, coupled with a growing lack of public trust (not to say aversion), testifies to a definite change in the prevailing mood regarding China and its actions, a fact that was decidedly unimaginable only a few years ago, and which is seriously jeopardizing mutual projects of economic and trade rapprochement. Therefore, it seems clear that the future of foreign direct investments between the two countries is, as of today, paved with challenges with an outcome that is difficult to predict. Indeed, as we observed, the main opportunities for a further development of the economic and commercial relations between China and Europe, namely the "One Belt, One Road" initiative and the "Comprehensive Agreement on Investment", appear all but close to being implemented. The growing skepticism hovering around these two plans (especially with regard to the former), coupled with the ever pending human rights issues which are officially blocking the CAI, has now far outweighed the predicted mutual benefits in terms of increase and facilitation of trade and investment between the two parties, the latter being a point that, in addition, has been extensively contested by several European governments and critics in recent times.

In the final analysis, based on the results obtained from this research, the following conclusions can be drawn:

- It appears evident that the amount of Chinese FDI in Europe is almost exclusively dictated by the government's agenda which, depending on the national development goals it has set, identifies the respective sectors, markets and key countries in which to invest. Moreover, these goals are often aimed at closing that industry-specific gap with European companies which still characterizes much of China's economic fabric, particularly with regard to the development of high value-added technologies, recognizable brands, marketing and R&D capabilities and, more in general, of the knowledge and know-how

deeply rooted in the respective specialized industries of the Old Continent;

- It has also become apparent how, in the recent years, the Chinese government's plans regarding foreign direct investment to the European Union have changed. The new strategy, whose main goal is the development of a domestic market that can transform the country from a territory devoted to exclusive production and export to a territory of domestic consumption, seems to be more focused on harnessing the benefits of the investments made in the past so as to further develop and integrate them into its own economic and productive fabric. Evidence of this new strategic vision is the "Made in China 2025" plan, designed to restructure the entire domestic industry and convert the country from a producer of quantity to a producer of quality;
- Although not concretely quantifiable, the events of the past few years have cast a decidedly gloomy light on the future of political and trade relations between China and Europe. Beginning with the trade war with the U.S. and moving through the pandemic and the Russia-Ukraine armed conflict, we are indeed witnessing a gradual alienation in the relationship between the two powers. At the moment, the picture presents scenarios that are difficult to predict and highly volatile, as indeed evidenced by the now chronic stalemate in the bilateral dialogues concerning two of the major trade development projects between the two parties, the "One Belt, One Road" initiative and the "Comprehensive Agreement on Investment";
- Finally, it becomes paradoxically clear how, despite the intent to search for determinacy, the conclusions deriving from the analysis carried out in this paper do not allow, as of today, to make certain predictions regarding the future of the flow of foreign direct investments between China and Europe. The actual context, characterized by minimized bilateral relations and mainly focused on more critical and urgent issues, though not appearing to be permanent in nature, does not allow too much room to be optimistic about a resumption of the dialogue between the two powers in the short term. However, barring any distant and worrisome scenarios, it still appears unlikely that the process of mutual exchange of FDI will come to a definitive halt in the long run. It may instead enter a new phase, probably more restrained in terms of percentages and amounts invested, but not any less strategic or noteworthy.

In conclusion, in an effort to clarify and provide a more predictable future not only for the flow of FDI between China and the European Union, but also for the political-economic relations between the two, further research appears to be required. First of all, in view of China's supposedly not-so-distant reopening to the world following the termination of the state of emergency caused by Covid-

19, monitoring FDI outflows appears to be of paramount importance, so as to ascertain when and whether the situation will return to the pre-pandemic crisis levels. In addition, the impact of the Chinese government's new policies regarding the development of the domestic market, coupled with the restructuring of the previous production and economic models launched with the "Made in China 2025" plan, is yet to be revealed, both at the country and global levels. Finally, the possible long-term effects related to a still little-examined process such as the one of *decoupling* deserve special attention, as it may play a fundamental role in re-shaping the future balance between the world leaders.

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