World Economy Brief

April 15, 2021 | Vol. 11 No. 23 | ISSN 2233-9140

China's FDI in Europe and Europe's Policy Response

Pyoung Seob Yang Senior Research Fellow, China Region and Strategy Team, Chinese Economy Department (psyang@kiep.go.kr)
Cheol-Won Lee Principal Researcher, Europe Team, Advanced Economies Department (cwlee@kiep.go.kr)
Suyeob Na Principal Researcher, Chinese Economy and Trade Team, Chinese Economy Department (syna@kiep.go.kr)
Taehyun Oh Senior Researcher, Europe Team, Advanced Economies Department (asroc101@kiep.go.kr)
Young Sun Kim Senior Researcher, Chinese Economy and Trade Team, Chinese Economy Department (youngsun@kiep.go.kr)
Hyung Jun Yoon Researcher, Europe Team, Advanced Economies Department (hjyoon@kiep.go.kr)
Yoo-Duk Gang Professor, Hankuk University of Foreign Studies (ydkang@hufs.ac.kr)

I. Introduction

China's investment in the European Union (EU) increased significantly during the European financial crisis, but has been on the decline in recent years. The surge of Chinese investment has raised concerns and demands for analysis on the negative effects it could have on the EU companies and industries. The largest economy in the world, with an advanced capital market and technology, the EU has been China's most important economic partner in the course of the latter's rapid growth. In this context, the present study aims to analyze the main characteristics of Chinese investment and M&A in Europe, major policy issues between the two sides, the EU's policy responses, and prospects of Chinese future investment in Europe, going on to draw important lessons for Korea.

This study differentiates itself from prior research by analyzing main characteristics of the EU's M&A market and China's investment to produce implications for Korea. This study further distinguishes itself through its use of primary data to capture indirect Chinese M&As via third countries (e.g. Hong Kong) or Chinese subsidiaries already established in Europe. Until now, existing studies were only able to analyze direct M&As from mainland China due to limitations of available data. Thanks to the new approach, the study presents a more complete picture of Chinese M&A in Europe and captures distinctive features of the two types of M&A.

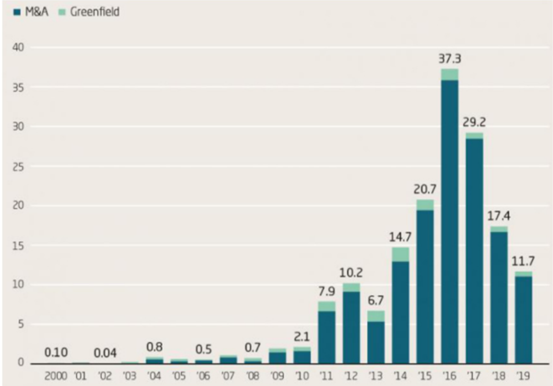
We focus on three key issues, as follows: first, the overall status of China's investment in Europe and the characteristics of M&A in Europe were examined; second, major investment issues and policy responses in China and the EU were reviewed; and lastly, China's investment decision-making factors in Europe were analyzed and compared with those of Korea, leading to implications for Korea.

With regard to the second issue, the study compared policy responses of the EU to the US vis-à-vis Chinese investment. First, the study analyzed China's investment strategies in the US and the EU respectively. Especially, the study focused on China's recent investment moves in Eastern Europe, predicting the possibility of future strategic changes. In order to link these analyses to implications for the Korean government and businesses, quantitative analysis techniques such as factor analysis of investment decisions were used to show determinants of Chinese investment compared against that by Korea.

II. The characteristics of China's investment in Europe

To summarize the main characteristics of China's investment in Europe, the study found that the EU's share of China's overseas direct investment has continued to increase until recently. Second, investment in the Central and Eastern European Countries (CEECs) is gradually increasing, although it is still insignificant compared to the top five destinations in the EU: Netherlands, Sweden, Germany, Luxembourg and France. Third, China's investment in the EU is being made in pursuit of innovation in manufacturing and to acquire high-tech technologies.

Figure 1. Composition of Different Modes of Chinese Investment in the EU



Note: Investment in EU28 (including the UK)
Source: Rhodium Group, MERICS (2020), p.9 (accessed: 2020.10.9)

Using data from Thomson Reuters information system as a primary source, the study collected and analyzed 1,172 M&A cases conducted by China in the EU between 2000 and 2019. The main characteristics identified are as follow. First, the number of China's M&As in the EU decreased to 113 in 2019 from a maximum of 206 in 2016, showing fluctuation largely in line with China's overall trend of overseas investment. Second, when compared to overall M&As made in the EU, the proportion of indirect China's M&As was relatively higher than direct ones. Third, the study found that Chinese investment mainly targeted Western European companies. Investment in Germany, France, and the United Kingdom represents 49.5 percent in terms of number of cases and 74.3 percent in terms of amount invested. Fourth, in the case of CEECs, investment has been in full swing since 2010. Targeted sectors are mainly transportation infrastructure and construction materials such as ports and airports, which seem to be related to China's Belt and Road Initiative (BRI).

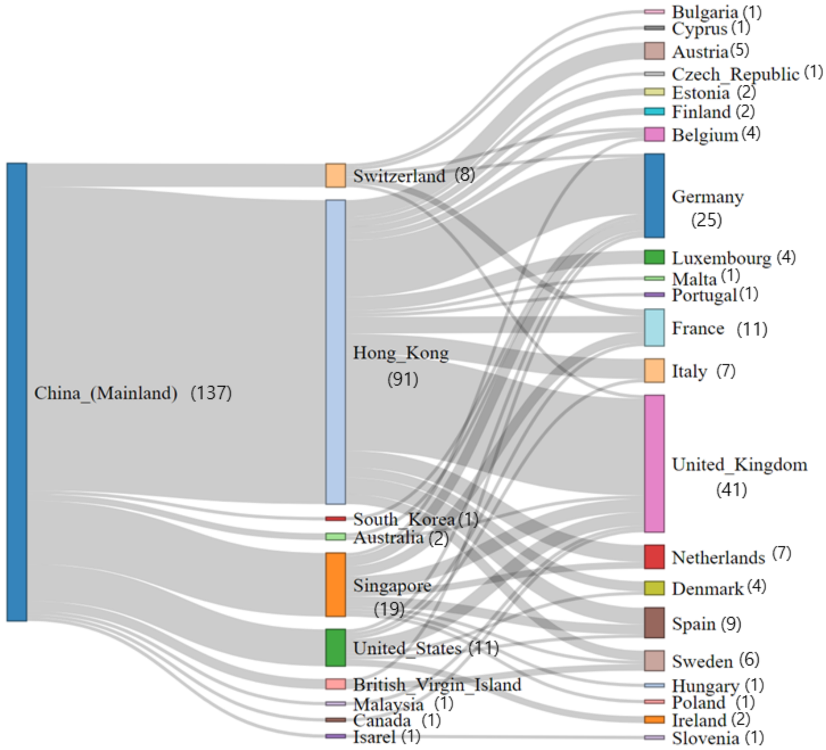
Table 2. Composition of Different Channels of Chinese M&A in the EU

Channel	Case (%)
China's M&A via domestic market (e.g. China → France → France)	191 (16.3)
Domestic M&A via China (e.g. France → China → France)	0 (0)
China's Direct M&A (e.g. China → China → France)	756 (64.5)
3rd country-involved M&As	225 (19.2)
China's M&A via non-EU countries (e.g. China → Hong Kong → France	137 (11.7)
China's M&A via another EU member state (e.g. China → Germany → France)	74 (6.3)
EU's M&A via China (e.g. Germany → China → France)	0 (0)
3rd country's M&A via China (e.g. Germany → China → HongKong)	14 (1.2)
Total	1,172

Source: Author's own compilation based on data collected from Thomson Reuters(EIKON) (accessed: 2020. 10. 9)

Figure 2. China's M&A via Non-EU Countries

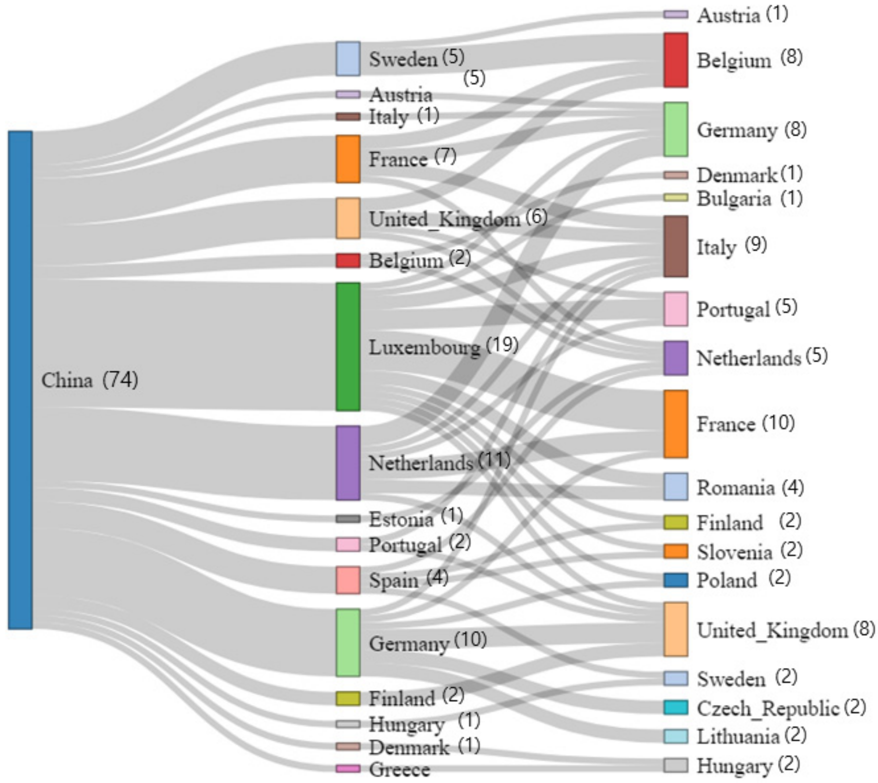
(Unit: cases)



Source: Author's own compilation based on data collected from Thomson Reuters (EIKON) (accessed: 2020. 10. 9)

Figure 3. China's M&A via EU Member States

(Unit: cases)



Source: Author's own compilation based on data collected from Thomson Reuters (EIKON) (accessed: 2020. 10. 9)

As there are many companies in the CEECs that are competitive in the high-tech and strategic technology sectors, there is a good possibility that Chinese companies will increase M&A investments in this region, bypassing investment regulations of major Western European countries. Although it is too early to fully confirm this, the study underlines some indirect evidences. First, China's M&A investment in the CEECs is largely concentrated in the Czech Republic, which is the most advanced in terms of technology. Second, the CEECs are less wary of China's M&A investment than major Western European countries, and are generally more welcoming to China's investment.

Empirical factor analysis of investment shows that China's investment in the EU is strongly motivated by the pursuit of strategic assets. Other factors such as institutional-level and regulatory variables are found to have no significant impact, or have an effect contrary to expectations. This suggests that China's investment in the EU is based on the Chinese government's growth strategy, and accompanies an element of national capitalism. China's investment is also found to be sensitive to the degree of taxation and openness in investment, which can be attributed to state-run companies leading this investment. When compared to China, Korea's investment is largely concentrated in the

CEECs and more prone to make greenfield investments in the manufacturing sector. The factor analysis also shows that Korea's investment strategy is more about integrating with Europe's value chain than acquiring core technologies.

Table 3. Pooled OLS Analysis : China's Investment Decision-Making Factors (2004-2017)

	(1)	(2)	(3)	(4)	(5)	(6)
GDPit	2.072***	1.620***	2.004***	2.974***	2.046***	1.993***
	(0.179)	(0.195)	(0.178)	(0.426)	(0.179)	(0.185)
GDP_perit	-1.321***	-0.902**	-2.456***	-2.968***	-1.415***	-1.999***
	(0.341)	(0.358)	(0.465)	(0.763)	(0.340)	(0.416)
Opennessit	3.960***	2.706***	4.015***	3.759***	3.239***	4.535***
	(0.463)	(0.498)	(0.459)	(0.467)	(0.487)	(0.462)
Manufactureit	-2.943***	-2.753***	-3.974***	-3.328***	-2.674***	-3.273***
	(0.431)	(0.448)	(0.522)	(0.468)	(0.427)	(0.442)
Inflationit	-0.561***	-0.512***	-0.528***	-0.513***	-0.459***	-0.661***
	(0.156)	(0.149)	(0.155)	(0.157)	(0.152)	(0.150)
Unemploy-mentit	0.690*	-0.090	0.545	0.499	1.217***	0.623
	(0.397)	(0.420)	(0.395)	(0.403)	(0.411)	(0.424)
Debtit	-0.695**	-0.517	-0.788**	-0.574*	-1.093***	-0.543*
	(0.313)	(0.316)	(0.310)	(0.317)	(0.312)	(0.324)
Export_cnit		0.944***				
		(0.296)				
Import_cnit		0.269				
		(0.443)				
R&Dit			1.524***			
			(0.424)			
Researcherit				0.984**		
				(0.390)		
IPRit					0.399***	
					(0.111)	
Euro						-1.241***
						(0.366)
EU15						1.937***
						(0.576)
English						0.168
						(0.426)
German						1.200**
						(0.474)
French						-1.141***
						(0.438)
Constant	-47.589***	-30.445***	-31.481***	-58.171***	-46.898***	-41.239***
	(5.268)	(6.713)	(6.616)	(7.258)	(5.336)	(6.854)
observations	267	241	260	259	256	267
R-square	0.467	0.536	0.489	0.472	0.510	0.529

Note : Standard errors in parentheses,
*** p<0.01, ** p<0.05, * p<0.1

Table 4. Panel Data Analysis (Fixed Effect): : China's Investment Decision-Making Factors (2004-2017)

	(1)	(2)	(3)	(4)	(5)
GDPit	15.988***	14.187***	16.516***	15.186***	15.874***
	(4.480)	(4.874)	(4.674)	(4.375)	(4.560)
GDP_perit	-14.889***	-13.288***	-15.876***	-13.962***	-14.723***
	(4.530)	(4.947)	(4.687)	(4.410)	(4.570)
Opennessit	6.716***	4.875***	4.122**	2.727	6.823***
	(1.718)	(1.761)	(1.876)	(1.856)	(1.785)
Manufactureit	-5.226***	-4.866***	-5.106***	-4.399***	-4.648***
	(1.343)	(1.315)	(1.444)	(1.310)	(1.365)
Inflationit	-0.398***	-0.284**	-0.326**	-0.210	-0.380***
	(0.133)	(0.130)	(0.134)	(0.134)	(0.134)
Unemploy-mentit	0.055	0.334	-0.198	0.133	0.052
	(0.529)	(0.535)	(0.535)	(0.524)	(0.552)
Debtit	0.655	0.076	0.917	0.902	0.460
	(0.636)	(0.667)	(0.648)	(0.629)	(0.666)
Export_cnit		1.422***			
		(0.521)			
Import_cnit		1.124*			
		(0.640)			
R&Dit			3.649***		
			(1.075)		
Researcherit				4.830***	
				(0.977)	
IPRit					0.060
					(0.225)
Constant	-287.609***	-241.857***	-281.707***	-287.978***	-287.841***
	(73.335)	(80.429)	(77.012)	(71.741)	(74.894)
Observation	267	241	260	259	256
R-square	0.430	0.480	0.455	0.484	0.413
n. of panels	33	27	33	33	33

III. Prospects and Implications

It is highly expected that the COVID-19 pandemic will have a reorganizing effect on the global value chain (GVC). Greater fluctuation is expected in major advanced economies, including Europe, as they are strengthening control on foreign investment. To begin with, a post-COVID Europe is expected to gradually increase the proportion of its regional value chain (RVC) within the GVC. Moreover, changes will be centered on smart manufacturing in the era of the fourth industrial revolution. These economies are also expected to further diversify their supply chains in order to hedge against other risks on the global level.

Foreign investment regulation in the high-tech sector motivated by national security is emerging as a global issue as the US and the EU are tightening their control. As Korean companies are not free from the risk of falling under such regulations, a thorough and careful response is required. Given that such regulations principally target China, and Korea is known as a traditional ally of the US and the EU, there is not much concern that these companies will be placed on the list of main regulatory targets. However, it should be noted that major countries have set the high-tech sector as future strategic industries and are highly sensitive to cases of technology leakage and issues of national security.

For the Korean government, it is necessary to prepare legal and institutional measures regulating foreign investment in reference to the US and the EU. In this regard, the recent revision of the Act on Prevention of Divulgence and Protection of Industrial Technology (promulgated on August 20, 2019 and implemented on February 21, 2020) strengthened the basis and effectiveness of foreign M&A regulations. Cases of regulating foreign investment in the name of national security are becoming an important trade issue, particularly in the US and EU, and conflicts are expected to continue. In particular, the scope of national security review is expanding. Korea also needs to respond more actively to these new trade issues. To this end, it is necessary to clearly establish the concept of national security and standards for application in reference to relevant legislation changes in economies such as the US and EU, and to prepare more specific definitions of national core technologies, and their scope and deliberation procedures, to enhance the enforcement capability of the revised law. KIEP