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China in Europe:

FDI Trends and Policy Responses in the 17+1 Region and Austria

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Abstract

Finding common ground across EU member states in responding to China's increasingly prominent position in the global economy has thus far proven a challenge. As the EU tries to find a 'third way' for dealing with its most important trading partners amid heightened US-China tensions, selected countries within the CESEE region have been deepening their investment relations with China. Given these countries' significant capital needs for economic development, and in view of the EU's arguable neglect of parts of the region, it is hardly surprising that they would be incentivised to seek out alternative investors. In addition to managing the risks arising from debt dependencies, China's growing position in the 17+1 countries' energy sectors may present a possible risk area. The EU investment screening mechanism is unlikely to align strategic interests across member states in its present scope, given the deficiencies in enforcement. With Austria's established investment presence and relative geographical proximity to the 17+1 countries, it needs to play a key role in moving the dialogue in the direction of harmonising EU investment screening mechanisms, aligning incentives through greater involvement of the Western Balkans in development financing from the EU and offering realistic EU accession prospects. The Comprehensive Agreement on Investment (CAI) would have constituted a positive step towards a mutually beneficial and competitively neutral investment relationship with China, despite its numerous shortcomings. Austria and the EU-CEE countries should therefore lean towards resumed engagement with China regarding the possible ratification of the CAI, keeping core European values in mind. The EU should prioritise proactive policies to drive growth at home, leveraging the continent's innovation capacities, and not only rely on defensive mechanisms to keep out unwanted FDI. Ultimately, Austria should recognise and emphasise mutual respect and co-operation towards common goals among the world's major trading blocs, despite sometimes profound differences in economic models.

Keywords: EU, China, foreign direct investment, investment screening, investment agreements

JEL classification: F13, F21, F42

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China in Europe: FDI trends and policy responses in the 17+1 region and Austria

1. INTRODUCTION

China's extraordinary economic ascent in the past decade has made it the world's second-largest economy, and along with the US and the EU, one of the three major blocs that define and dictate the global trading environment. Its vast outward investment agenda and rapid climb up the innovation ladder has seen China's role in the global economy move beyond that of merely the 'world's factory'. Consequently, tensions in US-China relations are intensifying and the EU is increasingly confronted with the need to find a suitable response strategy for dealing with its two most important trading partners. However, finding a common narrative within the EU has thus far proven a challenge, with attention often directed to the growing closeness of China with certain CESEE countries through investments and loans, many of which involve critical infrastructure projects.

At the same time, the bottlenecks and supply shortages brought on by the COVID-19 crisis have exposed the vulnerabilities of global value chains, prompting policy makers to reassess the risks involved in an internationally fragmented production process. Reiter and Stehrer (2021) find that China accounts for over a fifth of Austria's imports of 'risky' products and almost a third in the EU overall, with high-tech industries predominantly at risk. Consequently, strengthening resilience and avoiding dependence has become an integral part of post-pandemic recovery strategies, and also in foreign investment policy.

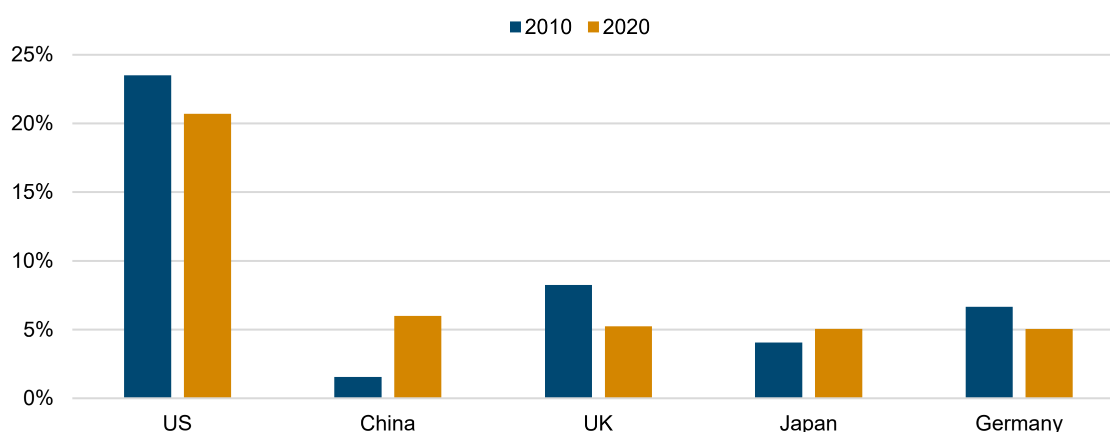
Against this background, this policy note addresses the economic implications of two major EU-China investment policy instruments, namely the EU Framework for FDI Screening and the Comprehensive Agreement on Investment (CAI), with a particular focus on the '17+1' countries[1] and Austria. The paper is organised as follows: first, an overview of Chinese FDI in the region is given, highlighting the still minor but growing role played by Chinese firms. Secondly, the implications of the EU's investment screening mechanism are discussed. Thirdly, the currently halted CAI is assessed, reviewing the agreement's main contributions and shortcomings with regard to the prospects of future Europe-China co-operation. Finally, the paper concludes with policy implications from an Austrian perspective.

[1] For the purpose of this policy brief, 15 CESEE economies within the 17+1 format are considered: Greece is omitted from the discussion and the datasets. In addition, given Lithuania's announced exit from the group in May 2021, it does not consider Lithuania. See Lau (2021) for a discussion of the exit announcement.

2. CHINESE FDI IN CESEE: MINOR, ALBEIT GROWING, CREATING SPACE FOR POSSIBLE FUTURE DEPENDENCIES

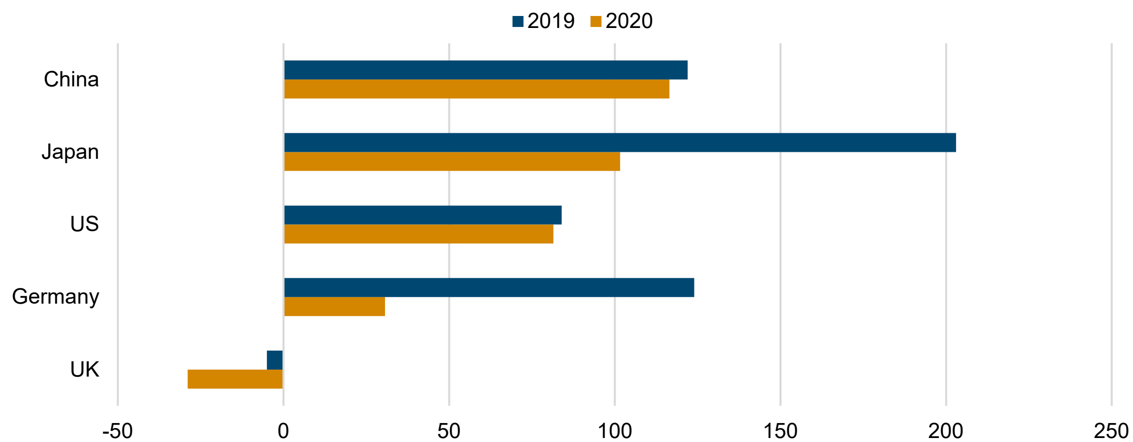
Since the introduction of its 'going out' strategy more than two decades ago, China has evolved from an emerging economy with a negligible position in foreign markets to a key player in the foreign investment arena. In the 2010-2020 timeframe, we can observe a notable increase in the share of FDI outward stocks held by China, as depicted in Figure 1. In 2010 China claimed a humble 1.5% of the global FDI outward stocks, significantly below that of developed economies such as Germany, Japan, UK or the US. Ten years later, China has overtaken all of these economies except for the US, and now holds 6% of the world's FDI outward stocks. In turn, we can see that China's growing stake in outward FDI activities has diluted the shares of Western developed economies. Moreover, China's outward investment volumes have proven largely resilient to the pandemic, unlike those of other major world economies, which have cut down sharply on outward FDI. Consequently, as can be seen in Figure 2, China has become the largest investor in the world in relation to FDI outflows, amid the extraordinary circumstances brought about by the pandemic in 2020.

Figure 1 / Share of FDI outward stocks held by selected economies, 2010 and 2020 (% of global total)



Note: Global FDI stocks exclude financial centres in the Caribbean. Excludes intra-EU FDI.
Source: UNCTAD.

Figure 2 / FDI outflows by economy, 2019 and 2020 (EUR bn)



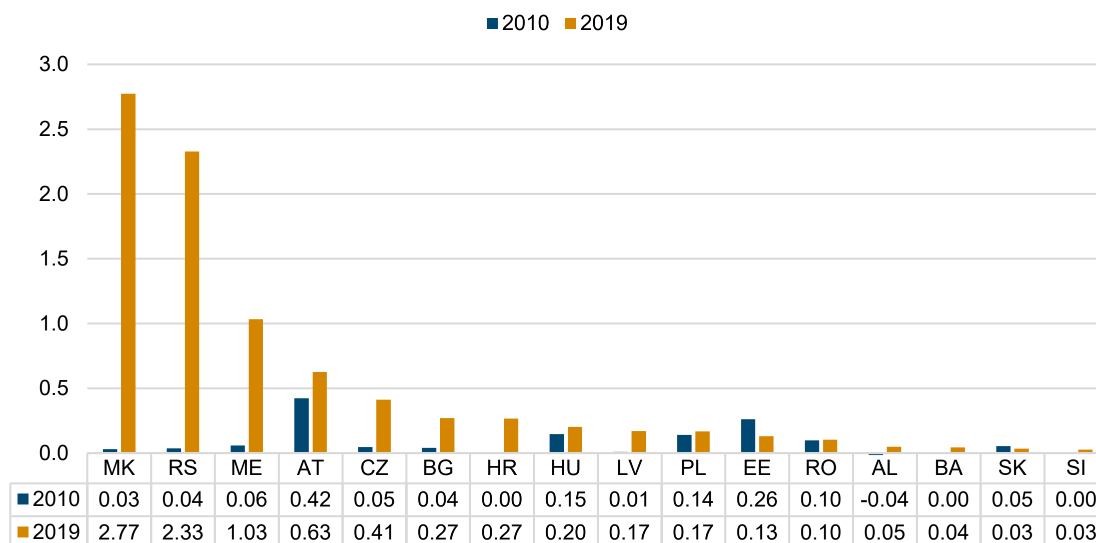
Note: Values converted from USD to EUR using exchange rates from OECD's conversion rate database. Excludes intra-EU FDI.
Source: UNCTAD.

China's stake in FDI stocks of the 17+1 countries remains minor, albeit growing (see Figure 3). In most of these economies, FDI stocks held by Chinese enterprises are still below 0.5% of the total. The same picture holds for Austria, where preliminary figures suggest that Chinese FDI stocks stood at 0.46% of the total volume in 2020.[2] However, China's position is more pronounced in the non-EU member states within the 17+1 framework, with its presence in Serbia, North Macedonia and Montenegro particularly standing out.

Aside from the generally smaller presence of foreign investors in the Western Balkan countries, related to differences in development levels across CESEE, the greater interaction with the non-EU economies also reflects their greater keenness to attract Chinese FDI. The fact that these economies cannot rely on EU grants and loans for development to the same extent as those in the single market makes them more inclined to seek out investors from third countries in order to meet their capital needs (Kratz et al., 2016). From the perspective of some EU member states, the growing linkages between the Western Balkan countries and China presents an obstacle in EU enlargement discussions. However, the inability of these economies to integrate fully into the European single market is an important factor behind their increasingly close relations with China.

[2] Calculations based on data from OeNB, preliminary data.

Figure 3 / Chinese FDI inward stocks in Austria and the 17+1 economies, 2010 and 2019 (% of total FDI stocks in the host economy)



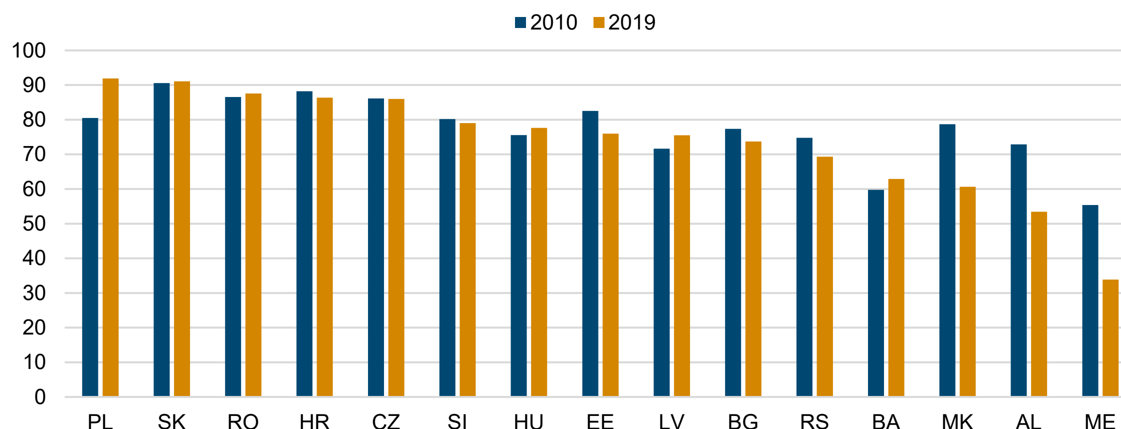
	MK	RS	ME	AT	CZ	BG	HR	HU	LV	PL	EE	RO	AL	BA	SK	SI
2010	0.03	0.04	0.06	0.42	0.05	0.04	0.00	0.15	0.01	0.14	0.26	0.10	-0.04	0.00	0.05	0.00
2019	2.77	2.33	1.03	0.63	0.41	0.27	0.27	0.20	0.17	0.17	0.13	0.10	0.05	0.04	0.03	0.03

Note: Negative partner country shares arise if total stocks are positive but there is repatriation of capital by the selected partner country – see wiiw FDI database.
Source: wiiw FDI database, calculations based on OeNB data.

Nonetheless, the EU, Switzerland, the US and Canada still make up the lion's share of FDI in the 17+1 economies. In 2019 the average share of FDI stocks held by these four markets was 83%, with the EU claiming the vast majority, particularly in the EU-CEE countries (see Figure 4).[3] Austria remains a key strategic investment partner across the region, with its share of FDI stocks in these countries averaging 10.6%, and reaching almost a quarter of all FDI stocks in Slovenia and Croatia. Austria is the single largest investor in Bosnia and Herzegovina, Croatia, North Macedonia, and Slovenia. Yet, as Figure 5 illustrates, Austria's dominance in the region is gradually decreasing over time, mirroring China's rise. It must also be noted that the presented figures fail to capture Chinese firms investing through special-purpose entities in other countries. Consequently, there may be a degree of underreporting of Chinese investment and overstatement of the Austrian presence, as Austria often acts as a platform for investment in the CESEE countries (Grübler et al., 2018).

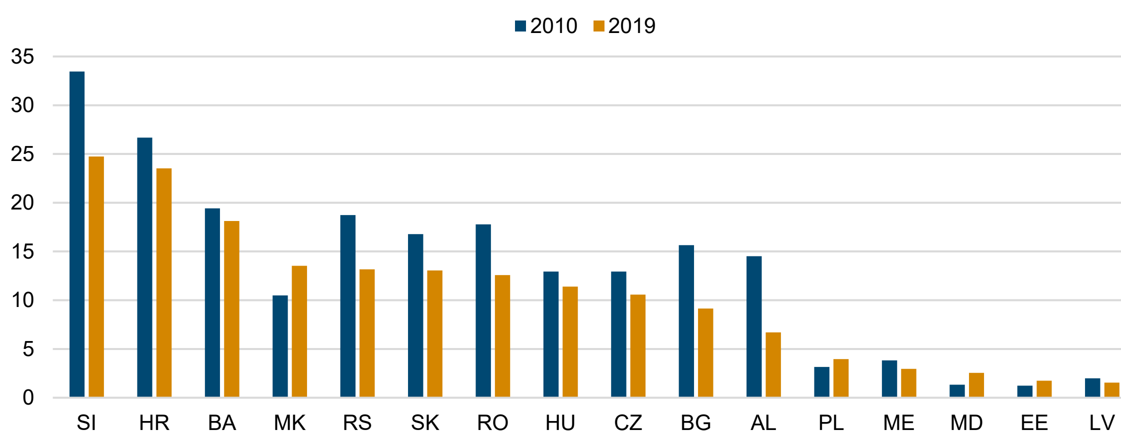
[3] According to wiiw data.

Figure 4 / FDI inward stocks held by EU27 in the 17+1 economies, 2019 (% of total FDI stocks in the host economy)



Source: wiiw FDI database.

Figure 5 / Austrian FDI inward stocks in the 17+1 economies, 2019 (% of total FDI stocks in the host economy)



Source: wiiw FDI database.

Generally speaking, FDI takes the form of acquisition of existing assets (through mergers and acquisitions), or investments in new assets entailing the building up of facilities, referred to as ‘greenfield’ investment. Examining greenfield investment projects over recent years, which depend purely on the investing firm’s internal capacities and the host country’s intrinsic attributes (Davies et al., 2015), we see some heterogeneity in the levels of incoming greenfield FDI from China within parts of the 17+1 framework. Again, Montenegro and Serbia stand out when considering the relative impact of the individual incoming investments, with capital investments from China over the past 3.5 years representing over 2% of their GDP in each case (see Table 1). Chinese investment projects also contribute to capital accumulation and employment creation in the more advanced of the 17+1 countries, including Slovenia and the Visegrád Group, with the exception of Poland. The preference for these economies appears to suggest market-seeking motivations behind these investments, as Chinese firms that wish to gain access to the EU common market take advantage of skilled labour and relatively well-

developed infrastructure, combined with proximity to Germany, as well as less stringent restrictions and lower wages than in Western Europe. Overall, the relative levels of investment coming in from China in recent years in many of the 17+1 economies are quite comparable to those from the more economically advanced countries within the EU.

Table 1 / Chinese greenfield FDI projects in selected recipient countries (total for 2018-2021*; announced projects)

Destination country	Capital investment (% of GDP)	Capital investment (EUR m)	Jobs created (per million inhabitants)
Montenegro	2.646%	258.067	196
Serbia	2.161%	1,910.054	1666
Croatia	0.429%	354.262	296
Hungary	0.387%	861.672	260
Slovenia	0.261%	150.666	533
Germany	0.182%	5,704.878	123
Czechia	0.132%	410.336	86
Slovakia	0.121%	144.629	231
France	0.089%	1,989.579	61
Estonia	0.084%	28.575	128
Austria	0.074%	258.748	57
Latvia	0.072%	29.649	85
Bosnia and Herzegovina	0.053%	18.453	3
Poland	0.052%	453.324	69
Romania	0.018%	76.256	31
Bulgaria	0.005%	5.375	26

Notes: Data up to July 2021, preliminary data for 2021. Capital expenditure data includes estimated values by fDi Markets. GDP figures used in the calculation are at current prices and purchasing power standards as of 2019. Albania and North Macedonia do not appear in the dataset.
Source: Calculations based on fDi Markets and Eurostat.

Looking at the sectoral breakdown, we can observe China's notable focus on renewable energy investments in the 17+1 region in the 3.5-year period from the start of 2018 until mid-2021 (see Table 2). This could lead to growing dependence on China in future energy production. Here, solar and wind energy investments tend to dominate. This is consistent with the general shift in Chinese overseas investments towards greener energy projects in evidence in recent years (Springer, 2020). As China builds up its capabilities in renewable energy to become a key player in this sector, foreign FDI outflows in renewables further contribute to the country's ambitions to take a leading role in the energy production of the future. In this regard, China's growing position in the 17+1 countries' energy sectors may present a possible risk area, given national concerns surrounding energy security.

However, CESEE countries have so far struggled to embark on the green transition, and the non-EU member states lack sufficiently supportive financial and reform instruments such as the Recovery and Resilience Facility. In this regard, China's activities focused on green investments may to some extent again reflect the insufficient collaboration and initiative from the more developed parts of the European continent. In this sense, China's goals in renewable energy leadership may facilitate positive externalities in the 17+1 economies via investments in technology and deployment, bringing them closer to emission reduction targets and to the benefit of not just the investor and host economies (Chiu, 2017).

Table 2 / Greenfield FDI projects from China in the 17+1 economies, most represented sectors (total for 2018-2021*)

Sector	Number of greenfield FDI projects	Estimated capital expenditure (EUR m)
Renewable energy	11	842.02
Automotive components	11	248.98
Metals	9	773.95
Electronic components	8	301.80
Consumer electronics	7	216.89
Industrial equipment	6	43.93
Communications	5	124.78
Plastics	4	18.00
Consumer products	4	128.00
Transportation & warehousing	4	128.00
Chemicals	3	107.63
Aerospace	3	80.19
Automotive OEM	2	153.95

Notes: Data up to July 2021, preliminary data for 2021. Capital expenditure data includes estimated values by fDi Markets. Albania and North Macedonia do not appear in the dataset.
Source: fDi Markets.

The above FDI figures show that, given China's latecomer status to the FDI scene, its outward stocks accumulated over the past decade in the 17+1 countries are still dwarfed by those of developed Western economies, with Austria among those at the forefront. Therefore, at present, at the macro level there is no evidence suggestive of overexposure to Chinese FDI across Europe (Poitiers and Domínguez-Jiménez, 2020), although this does not mean that there are not specific cases of Chinese investment in the region that provoke concern about political influence, debt dependency or risks to macro-financial stability (as outlined in the following section). Nevertheless, the fact that China was able to overtake prominent economies such as Germany, the UK and Japan in the share of global FDI outward stocks in less than a decade shows remarkable growth potential. Combined with the focus on strategic areas such as renewable energy production, it could pave the way for future dependencies in certain sectors, particularly in selected non-EU member states within the 17+1 group. From a purely economic standpoint, however, there are also numerous benefits to be reaped from the incoming Chinese financial flows into the region, given the positive externalities associated with boosting alternative energy production, as well as from industrial capacity building across the 17+1 economies.

3. CHINA'S CAPITAL EXPANSION IN THE REGION BEYOND FDI

China's international expansion through capital flows is not limited to FDI. Perhaps the most significant of China's international pursuits from the perspective of the CESEE countries is the Belt and Road Initiative (BRI), which was the fundamental reason behind the establishment of the 17+1 framework in the first place. BRI projects are generally undertaken through debt instruments rather than FDI, with the Chinese government making use of a dedicated sovereign wealth fund, national development banks and multilateral development banks (such as the Asian Infrastructure Investment Bank) for financing (Sejko, 2017). Through the BRI, China has engaged heavily in transport and energy infrastructure projects in the region, investing almost USD 22.5bn in the CESEE 17+1 countries since the establishment of the

initiative in 2013, which represents roughly a third of all BRI investments in Europe.[4] Southern European economies including Italy, Greece and Portugal also rank among major BRI investment recipients.

Given the substantial investment needs in infrastructure CESEE countries (see Holzner et al., 2015), BRI's economic effects are deemed positive, both from a short- and a long-term perspective. Infrastructure development in the region through the BRI has the potential not only to catalyse demand in the construction sector domestically, but also to create spill-over effects in trading partner countries over time (Grübler et al., 2018). As Austria is a key trade and investment partner in the region, it can also stand to benefit from the BRI's concentration on CESEE.

However, the reputation of BRI projects has been somewhat tainted in recent years, given the numerous formidable challenges surrounding its implementation. As Chinese public procurement and environmental standards fall short of the levels of protection demanded by the EU, undue advantages arise on the side of Chinese firms, which, it is argued, erode the competitiveness of domestic firms. Likewise, because infrastructure projects often rank high in terms of national interest, and given the explicit or implicit state involvement in Chinese enterprises, the projects are often reviewed with caution and scrutiny owing to possible geopolitical influence arising from foreign control. Furthermore, the growth-enhancing effects of BRI investments may not be meeting their potential in view of a lack of involvement of local labour, suppliers or materials (Grübler et al., 2018) Meanwhile, implementation of these projects often suffers substantial delays for various reasons, as seen in the case of the Budapest-Belgrade railway (Brînză, 2020).

Moreover, despite a lack of reliable data on the exact volumes, debt instruments are deemed to form a central part of BRI projects. Matura (2021) estimates that the exposure to Chinese loans may reach up to 18% of GDP in the case of Montenegro and 12% in Serbia, giving rise to questions of debt sustainability and levers of political influence. Here it must be noted that numerous investments have been announced at the 17+1 level, but given the data shortcomings, it is difficult to distinguish between projects that will actually materialise and those that will not, potentially creating an inflated impression of China's presence in the region (Matura, 2021). Nonetheless, the significant undertaking of Chinese debt financing by CESEE countries is undeniable. Indeed, Montenegro had to seek out hedging deals with international lenders to shield itself from foreign-exchange risks resulting from the sheer size of its Chinese loans (Reuters, 2021). Therefore, in addition to considering the interdependencies that may be created by FDI projects in sensitive sectors, it becomes important to monitor and manage the risks arising from debt dependencies that numerous 17+1 economies may be exposed to.

4. INVESTMENT SCREENING MECHANISMS CONTRIBUTE TO THE UNCERTAINTY OVER FUTURE CHINESE INVESTMENT PROSPECTS

As European economies become increasingly aware of the competitive challenges associated with China's remarkable rise and therefore more conscious of the need to safeguard their technological and proprietary knowledge, the EU has stepped up its deployment of defensive instruments, which also extends to FDI policy. A European Commission (EC) guidance in March 2020 urged EU member states

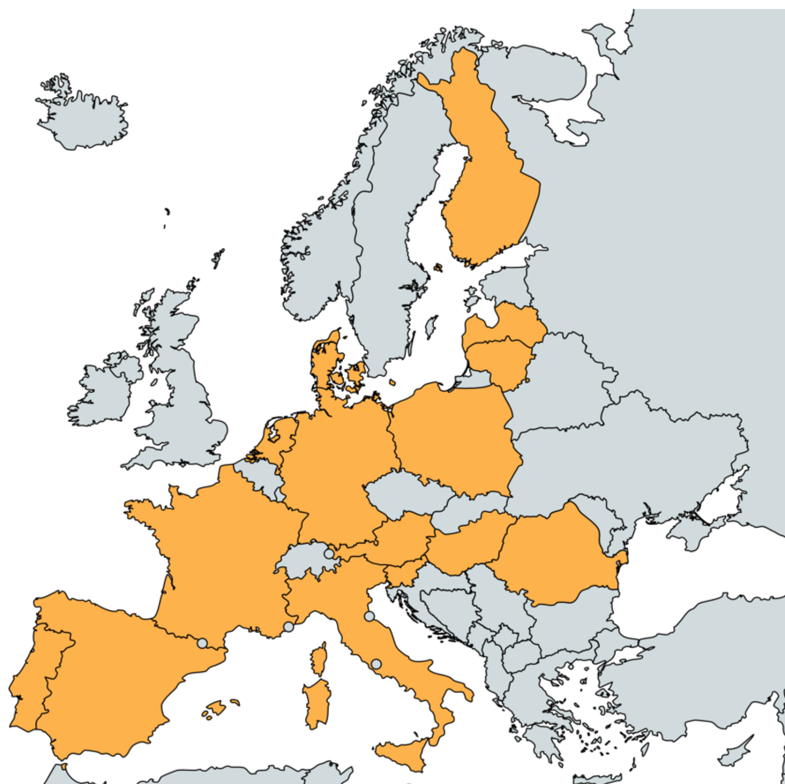
[4] Based on data from the China Global Investment Tracker.

to utilise their existing FDI screening mechanisms, or where absent, to set up a fully fledged screening mechanism (European Commission, 2020a).

The pandemic has further contributed to the already deteriorating sentiment towards FDI and globalisation at large. In view of the bottlenecks that can arise from exogenous shocks, the rhetoric has shifted from the growth-inducing effects of FDI to the security risks associated with foreign control and the benefits of re-shoring (Raza et al., 2021). UNCTAD (2021) reports that regulations and restrictions surrounding FDI more than doubled in 2020, primarily attributable to national security concerns. As Figure 6 shows, more than half of EU countries now have an investment screening system in place, although it is important to note that the implementation of such policies in many of these countries predates the EU's initiative for strengthened screening.

A contributing factor may also be the greater financialisation of FDI, whereby investment funds (including sovereign wealth funds) and private equity firms play an increasing role in cross-border acquisitions (European Commission, 2019). Political considerations associated with state-owned funds aside, financialisation has implications for economies pursuing FDI-oriented growth strategies. In contrast to FDI carried out by business entities specialising in the given sector, the spill-over effects to the host economy (e.g. knowledge transfers or supply-chain linkages with domestic firms) stemming from purely financial transfers may be rather minor. Hence, the greater reluctance of host economies towards FDI might to some degree be also a reflection of the diminishing economic benefits stemming from more 'financialised' foreign investment flows.

Figure 6 / EU member states with an investment screening mechanism in place



Note: Only EU countries are considered.
Source: based on EC (2020a).

In response to the above factors, eight EU member states – Austria, Czechia, France, Finland, Germany, Italy, Lithuania and the Netherlands – implemented new screening policies in 2020 (OECDa, 2020). In October 2020 the EU Framework for FDI Screening was introduced by the EC, aimed at creating a co-operation mechanism for information sharing on FDI across EU member states. This EU-wide FDI screening does not replace the existing screening systems member states have in place, nor does it prevent them from adopting their own frameworks or from operating without national screening mechanisms (European Commission, 2020a). Rather, the objective of the common screening framework is for EU nations to jointly evaluate potential cross-border threats that certain investments may bring, particularly with regard to critical infrastructure, technologies or access to sensitive information. The EU-wide investment screening is deemed to fall within the scope of the increasingly prominent EU Open Strategic Autonomy agenda, which aims to bring to the fore the EU’s role in global economic governance, to augment the EU's capacity to pursue its own interests, and to respond to ‘unfair and abusive practices’ (European Commission, 2021a).

China is often considered to be the core focus of this screening framework, as the guidance refers to numerous defining characteristics of the Chinese FDI strategy – including state backing of businesses, and orientation towards infrastructure and technological projects (Le Corre, 2019). Several EU-funded programmes appear on the list of critical areas for security and public order, including Galileo, Horizon 2020, Trans-European Networks and the European Defence Industrial Development Programme (European Commission, 2020a). In September 2021 the EU further stepped up its efforts in the strategic autonomy agenda through the introduction of the ‘Global Gateway’ scheme, intended to compete with the BRI (European Commission, 2021b).

Under the EU Framework for FDI Screening, a member state is obliged to provide information upon request about an incoming investment, provide notifications regarding national screening cases, and can request the EC and member states to provide comments. Once the EC and other member states issue their opinions, the recipient country is to take their guidance into account when authorising or blocking the foreign investment. The final decision nevertheless remains in the hands of the recipient member state, making these recommendations entirely non-binding. As the screening itself is carried out by the recipient country that the potential investor might be trying to influence, the impact of the framework may be somewhat limited in blocking investments with questionable motives (Poitiers and Domínguez-Jiménez, 2020). At the same time, non-EU countries of the 17+1 group do not participate in the common screening process. Therefore, a harmonisation of strategic interests in Europe beyond the single market remains out of reach – as Poitiers and Domínguez-Jiménez (2020, para. 14) note, however, this issue probably ‘requires a political solution, not a regulatory one’.

Global FDI flows have seen declines in recent years, independent of FDI screening policies. China’s investment policy has also tightened, increasingly limiting private capital outflows to focus on domestic consumption (Le Corre, 2019) and becoming more conscious of its current-account balance (Poitiers and Domínguez-Jiménez, 2020). Consequently, any future declines in FDI may be only partly related to the impacts of investment screening. Nonetheless, a widespread adoption of FDI screening mechanisms increases the transaction costs and uncertainty associated with FDI. As a result, it may limit the potential of FDI-led growth paths traditionally relied on by many of the EU-CEE countries. Furthermore, without harmonised investment screening systems beyond the EU, the concentration of Chinese investment in the non-EU countries of the 17+1 framework may further increase, giving preference to countries with a laxer investment environment. This may contribute to further misalignments across the continent.

Therefore, the key challenge going forward lies in striking the right balance between protecting national sensitivities through effective, targeted screening policies and maintaining a predictable and harmonised European investment climate conducive to international business.

5. COMPREHENSIVE AGREEMENT ON INVESTMENT: A SPRINGBOARD FOR FUTURE COOPERATION

Although, on the surface, contradictory to the investment screening mechanisms encouraged by the EU, the CAI can be regarded as a complementary investment policy vehicle for endorsing competitive neutrality in FDI and rebalancing the playing field. An agreement was reached at the end of 2020, after almost eight years of negotiations, but it was suspended in May 2021 following Chinese sanctions on EU officials in relation to disputes over the treatment of Uyghurs in Xinjiang (International Institute for Sustainable Development, 2021). Although its ratification in the near future is unlikely, evaluating the CAI's main contributions and shortcomings is nevertheless a useful exercise for setting the direction for future EU-China and 17+1 investment relations.

Before diving into the CAI, it is worthwhile to look at China's openness to investment over time. The OECD's FDI Regulatory Restrictiveness Index scores 69 countries on a scale of 0 (open) to 1 (closed) by considering restrictions in the area of foreign equity constraints, screening, possibility of employment of foreigners in senior positions, and operational restrictions (Kalinova et al., 2010). At the start of the previous decade, the Chinese economy was rather closed off to foreign investment, with an overall score of 0.56 – significantly above the OECD average of 0.07 (see Figure 7). Since 2014, however, China has substantially liberalised its policies and the secondary sector now approaches the OECD level in terms of its restrictiveness. Nevertheless, the economies of the 17+1 countries and Austria remain much more open to foreign investment (Figure 8), largely owing to China's stringent barriers in the primary and tertiary sectors.

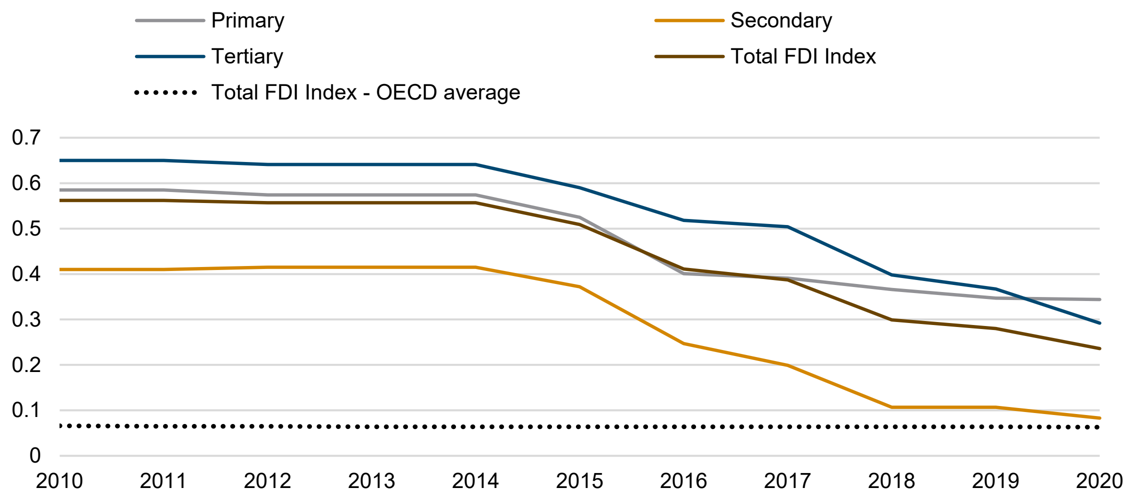
The CAI aims to address this imbalance. Under the CAI, China binds itself under an international treaty to not reverse the liberalisation of the past two decades, as well as to provide market access in a number of areas that have been closed off to foreign ownership. It lifts joint venture requirements, quantitative restrictions and equity caps in various sectors (European Commission, 2020b). Although it may at first sight appear as if the CAI would only offer greater market opportunities in China for foreign investors without offering anything new to the Chinese in return, the main value China would have derived from the CAI is the EU's commitment to openness towards China under an international treaty. Naturally, the equivalent commitment would be also valuable from the perspective of the EU.

In the manufacturing sector, the granting of market access for alternative fuel vehicles could be of particular relevance to European firms. However, greater openness in this segment could prove detrimental to automotive-heavy CESEE economies that aim to become strategic investment hubs for green-powered vehicles in the coming years.

Given China's relative openness in manufacturing, however, the terms agreed in the service sector are likely to be more interesting from the perspective of EU businesses. For instance, the CAI lifts many restrictions in financial services, including joint venture requirements and foreign equity caps in banking, security trading, insurance and asset management. Likewise, cloud services transition from having an

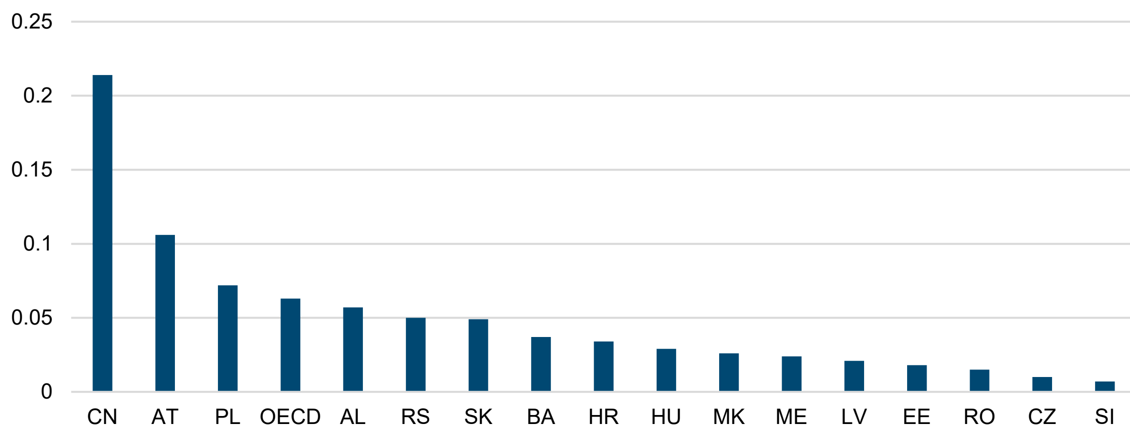
investment ban in place to a 50% equity cap restriction (European Commission, 2020b). The agreements reached in the service sector are negotiated under the Most-Favoured-Nation (MFN) provision, implying that market access is gained for all World Trade Organisation (WTO) member states (Weyand, 2021). Therefore, they also extend to the non-EU members of the 17+1 group and bring benefits to the EU's strategic partners.

Figure 7 / China's FDI Regulatory Restrictiveness Index by economic sector



Note: The index is on a scale of 0 (open) to 1 (closed).
Source: OECD.

Figure 8 / FDI Regulatory Restrictiveness Index by country (2020)



Note: The index is on a scale of 0 (open) to 1 (closed).
Source: OECD.

The CAI also complements the protections offered by investment screening mechanisms, by prohibiting involved parties from imposing or enforcing transfers of technology, production process or other intellectual property. This clause tackles the malpractice of offering a 'market for technology', and protects the intellectual property holder's contractual freedom and exclusive rights to proprietary

knowledge (Hu, 2021). Equally, the CAI deals with the issue of state-owned enterprises (SOEs) and tasks itself with better defining state control of businesses. The greater role played by SOEs in FDI, not limited to China's rise, has given momentum to the question of competitive neutrality, which asserts the importance of a level playing field, ensuring that no undue advantages stem from ownership, nationality or legal form of individual market participants (OECD, 2021). The CAI moves the discussion beyond state ownership to 'covered entities', extending to all levels of government and taking into account aspects such as the ability to appoint directors or influence decision-making without ownership stakes. Firms granted monopolies by the state are also considered a 'covered entity' under the CAI (Dadush and Sapir, 2021).

The main criticisms of the CAI relate to unclear dispute settlement as well as the insufficiently discussed labour and environmental standards. In terms of strengthening investor protection, the CAI presently does not propose anything beyond the already existing bilateral state-to-state dispute settlement mechanisms (García-Herrero, 2021). The ambition was to allow involved parties more time to agree on an alternative solution, but with the CAI's ratification having been put on hold, development in this direction remains uncertain. Besides, while there are provisions under which China commits to maintaining at least its present level of labour and environmental protection and to make progress with regard to its international obligations, the loose wording used in the agreement makes these requirements non-enforceable. Indeed, Cotula (2021) even raises the rhetorical question of whether China has not agreed to these terms precisely because they are virtually impossible to enforce.

Despite these shortcomings, there are many valuable aspects the agreement brings to the table, making it unwise to abandon the CAI altogether. From the perspective of Austrian businesses, the CAI could bring multiple economic gains. Through renegotiated market access in manufacturing as well as the newly opened-up segments of the service sector, it would enable the outward expansion of Austrian firms into the Chinese market, reaping the benefits arising from the growing affluence of Chinese consumers. Furthermore, it would allow them to do so without the previously present risks involving the unwanted dissemination of proprietary knowledge held by Austrian firms, through changes in joint venture requirements and prohibitions of forced technological transfers. In other words, it would level the skewed playing field between China and Austria in the area of FDI.

Furthermore, the CAI is the first trade agreement in which China has agreed on a sustainability provision (Dadush and Sapir, 2021). China's willingness to engage in sustainability discussions in the CAI can be used as a springboard to strengthen international co-operation in these crucial areas. Likewise, moving from bilateral agreements of individual member states with China to a common EU-China approach is desirable for consolidating bargaining power and unity within the EU.

At the same time, the CAI presents a useful starting point for achieving the WTO's long-overdue reform agenda, given its numerous shortcomings, not limited to the dormant negotiating function, inadequate dispute settlement, or a lack of responsiveness to trade aspects surrounding climate change or the digital revolution (Wolff, 2020). In this context, the criteria laid out in the CAI for defining state influence, for example, can be relatively straightforwardly translated from a bilateral to a multilateral setting. Given China's rising position in the global economy, the need to co-ordinate fundamentally different economic models at the multilateral level is becoming as relevant as ever. Including China in this dialogue presents the only reasonable way forward, and the CAI negotiations can be regarded as the first step in

this direction. At the time of writing, however, there is no indication of CAI negotiations resuming in the near future.

6. EUROPE-CHINA INVESTMENT RELATIONS IN THE POST-PANDEMIC WORLD – POLICY IMPLICATIONS FOR AUSTRIA AND THE 17+1 ECONOMIES

The pandemic has highlighted and accelerated many of the trends that were shaping the European economy following the Great Recession. Among these is the hardened geopolitical divide between China and the US, leaving EU countries in search of a coherent strategy for standing with their allies while remaining open to multilateral co-operation. The deteriorating sentiments towards globalisation at large and the rethinking of costs and benefits associated with a globally fragmented production process also contribute to the uncertainty surrounding FDI.

Given the openness of the 17+1 economies and their heavy reliance on foreign investment for employment and infrastructure development, it is important for these countries to understand the implications stemming from the recent developments in EU-China investment policy. Conversely, it is also important for Western Europe, including Austria, as well as the EU as a whole, to consider the unique challenges faced by the 17+1 countries, in order to find a common ground for dealing with major world economies, including China.

The 17+1 format itself presents a contentious issue, often seen as a vehicle to ‘divide and conquer’ Europe. However, despite China’s major geopolitical and geo-economic ambitions, the CESEE region is seen to rank quite low down Beijing’s list of priorities in this sense. Moreover, while acknowledging the geopolitical and geo-economic implications of China’s growing footprint in CESEE, it is also important to recognise that China is filling a void by reacting to the business opportunities and investment needs, particularly in the Western Balkans, neglected by the more economically advanced EU countries. Therefore, the EU should play a greater role in the economic development (not limited to infrastructure projects) of the non-EU member states of the 17+1 group, in order to reduce the likelihood of these countries giving up control over strategic assets for much-needed capital. Hence, in addition to harmonising investment screening mechanisms in critical areas beyond the EU to span all 17+1 economies, a greater involvement of the Western Balkans in development financing from the EU and realistic EU accession prospects would ensure a greater alignment of incentives. Given Austria’s established economic presence in these countries and relative geographical proximity, it needs to play a key role in moving the dialogue in this direction.

At the same time, as Austria already has its investment screening mechanism in place and updated these policies in 2020, it can provide support to the CESEE countries that have yet to formulate a strategy for responding to foreign investments in sensitive areas. Moreover, Austria and the other EU member states should consider entrusting greater power to the European Commission in the EU Framework for Investment Screening beyond providing unbinding comments to blocking certain investments that may have a long-term detrimental impact on the prosperity of the EU overall.

Moreover, given the aforementioned economic benefits associated with the CAI, Austria and the EU-CEE countries should push for a united EU engagement with China regarding the CAI’s possible

ratification, keeping in mind the need to balance business interests with core European values. In order to put the investment agreement with China back on the table, priority should be given to the lifting of sanctions imposed on EU officials by China and addressing the human rights issues at large. Emphasis should also be placed on a multilateral dialogue involving all major global economies, to better facilitate competitive neutrality within WTO rules and address the pressing issues surrounding climate change. Here, the lessons learned from the CAI negotiations can be useful, presenting a fruitful area for possible EU-China co-operation. With heightened tensions between the US and China, the EU can take the lead on initiating the dialogue on reforming the global trading architecture that would meet the needs of the increasingly complex market conditions. Ultimately, Austria should recognise and emphasise that mutual respect and co-operation towards common goals, despite profound differences in economic models, need to remain at the core of the discussions shaping future investment relations.

Perhaps most importantly, rather than using reactive strategies, proactive policies targeting endogenous growth within Europe should be prioritised. This presents a more constructive way of responding to China's extraordinary economic ascent and regaining Europe's international competitiveness. In this regard, Austria should press for the EU to establish itself as a globally relevant and systemically important economic bloc with solid bargaining power. Policies that strengthen and promote the innovative capacity of the economy are of particular significance in this wider strategic autonomy debate. Numerous European countries rank among the biggest innovators in the world, which offers great potential for the continent to become a serious competitor in strategic industries, including the much-debated semiconductor sector. Active participation in creating what Ursula von der Leyen refers to as 'ground-breaking European tech' (European Commission, 2021b) requires a strategic orientation towards research and development. At the same time, as China climbs up the innovation ladder, collaboration with the most innovative Chinese firms can potentially bring valuable knowledge spill-overs. There is a lot to be gained for Austria by pooling resources at the EU level, leveraging the numerous world-leading innovative companies and cutting-edge human capital to emerge as a relevant actor in the increasingly polarised global economy.

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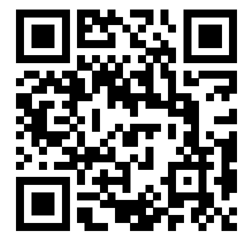

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