

# EU-CHINA OBSERVER

DEPARTMENT OF EU INTERNATIONAL RELATIONS AND DIPLOMACY STUDIES



"EXCHANGING IDEAS  
ON EU-CHINA RELATIONS:  
AN INTERDISCIPLINARY  
APPROACH"



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### ABOUT THE EU-CHINA OBSERVER

The electronic journal **EU-China Observer** is jointly published by the **Baillet Latour Chair of European Union-China Relations** and the **EU-China Research Centre** based in the Department of EU International Relations and Diplomacy Studies at the College of Europe in Bruges. The journal provides a platform for scholars and practitioners to further deepen the academic analysis and understanding of the development of EU-China relations from an interdisciplinary perspective.

The **EU-China Observer** publishes scholarly articles based on theoretical reasoning and advanced empirical research, practical policy-oriented contributions from all fields of EU-China relations, and conference reports on the annual conferences organised by the Baillet Latour Chair and the EU-China Research Centre. The journal targets academic audiences as well as policy practitioners, members of the business community, NGO representatives, journalists and other interested persons.

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With the financial support of the Baillet Latour Fund, the College of Europe established in 2008 the Baillet Latour Chair of European Union-China Relations and in 2014 the EU-China Research Centre. The **Baillet Latour Chair of European Union-China Relations** offers courses on EU-China relations at the College of Europe in both Bruges and NatoLin. It also organises guest lectures, international conferences and promotes multidisciplinary research on the European Union's relations with China. At the end of each academic year, the Chair grants an award for the best Master's thesis on EU-China relations.

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# EU-CHINA RELATIONS - THE WAY FORWARD

**AMBASSADOR NICOLAS CHAPUIS**

HEAD OF THE EUROPEAN UNION DELEGATION TO CHINA

**We are coming to an end of an eventful year, both for the world at large as well as the European Union and China. The rules-based international order is under increasing strain impacting the regional and global economic outlook. The EU and China are strategic partners and our joint action can make a positive difference globally. But we must also find solutions to pressing bilateral issues, including trade and investment.**

The last EU-China summit set an ambitious joint roadmap – raising even higher the visibility and relevance of our relationship in uncertain times. It was followed by a very intense period in our bilateral relations, with frequent high-level contacts, including a bilateral meeting of President Juncker with Prime Minister Li Keqiang on the occasion of the 12th ASEM summit in Brussels and both President Tusk and President Juncker attending the G20 in Buenos Aires alongside President Xi. More is to come, with EEAS Secretary General Helga Schmid expected in January. We also expect intensified work in preparation of the 21st EU-China Summit in 2019, to be preceded by a Strategic Dialogue at the level of High Representative and Vice President Mogherini and a High-Level Economic Dialogue co-chaired by Vice President Katainen.

Over the 15 years of our comprehensive strategic partnership we have learned to work together. We do not always see eye-to-eye; we have some fundamental disagreements. But as two global powers, we both understand that our cooperation is essential to address the main challenges we face. As we think about updating our cooperation objectives for the years 2020-2025, let me highlight topics

of particular importance to our current and future relations. First, trade and investment - reciprocity remains the watchword. The EU and China should finalise negotiations on an ambitious investment treaty and on an agreement on Geographical Indications (GIs) to protect Chinese and EU brands.

China is the EU's number two trading partner and we exchange 1.6 billion euro in goods every single day. But Europe wants to invest more in China on the basis of a level playing field and of agreed rules. The EU stands for open, transparent and predictable investment policies. We have always welcomed Foreign Direct Investments from all sources, as it has been very beneficial to the EU economy in terms of jobs, growth and innovation. We have one of the most liberal frameworks for FDI in the world. China knows this well, since Chinese investment into the EU was at EUR 28 billion (\$31,7bn) in 2017 despite the introduction by China of outward investment controls.

Investment negotiations, quest for reciprocity, a level playing field, fighting overcapacity and gaining market access – continue to form the backbone of our bilateral exchanges on trade. However, 40 years since reform and opening up, most of the market access barriers faced by European businesses in China are long-standing issues: companies face complex hurdles, including joint venture requirements, market entry restrictions, forced technology transfers, unjustifiable technical regulations and cybersecurity related barriers. Behind the border measures, such as licences play a significant role also in the case of China. It is also worrying that new barriers continue to emerge,

and there is an observable trend of the Chinese market becoming more difficult for foreign enterprises to navigate. The business confidence survey of the European Chamber of Commerce in China (EUCCC) shows it clearly. Half of the respondents said that doing business in China has become more difficult over the past year. Companies feel they have missed out on business opportunities as a result of regulatory barriers and limited market access.

We have taken careful note of the many public statements by the Chinese leadership about being open to the world. We welcome the announcements of market reform. It is very important that these announcements are followed by concrete action and swift implementation, to ensure fair competition between Chinese and European companies doing business in China.

We are looking forward to the conclusion of the negotiations on Geographical Indications. We missed a chance to do so at the Shanghai International Import Expo last November. Yet this agreement would be the first ever trade agreement between the EU and China. It would also be a strong signal to the world that we are committed to rules-based trade.

Second, we need to increase dialogue on global governance, on governance of public goods, and on increased connectivity.

We are staunch supporters of multilateralism and firmly believe that the WTO is indispensable in ensuring the stability of the global trading system and sustainable economic growth. We therefore welcome China's commitment to fostering an open world economy, improving trade and investment liberalisation and facilitation, resisting protectionism and unilateralism, and making globalisation more open, balanced, inclusive, and beneficial to all. China itself has benefitted enormously from the predictability and stability that the WTO system offers since China joined the WTO in 2001.

Now we need to take swift and determined action. The only way to uphold the multilateral trading system is to strengthen and modernise it. All three of the WTO's functions are in crisis and urgency for action must not be underestimated. The EU and China support reform the appellate body with specific proposals to avoid a paralysis and improve the dispute settlement mechanism. We call on China to also engage on work on notification obligations and ineffective committee procedures. These are hampering proper monitoring and enforcement. We

have to update the WTO rulebook to address today's trade challenges, including industrial subsidies and technology transfer. For the EU it is very important that China is at the table from the outset and is part of those who write the future rules. An ambitious engagement bolsters the credibility of China's declared support for the open and rules based multilateral trading system with the WTO at its core. Therefore, the work of the EU-China joint working group on modernising the WTO is an excellent way to deepen the work on solutions for all areas of reform.

We also need to improve Eurasian connectivity, and we recently published a blueprint on the topic. For both Europe and Asia, growing global interdependence is an opportunity for increased cooperation, for peaceful political cooperation, fair and stronger economic relations, comprehensive societal dialogue and collaboration on international and regional security. Europe and Asia, together, can be the engines of a more cooperative approach to world politics, global stability and regional economic prosperity. The EU will proactively seek to identify synergies between our and our partners' connectivity strategies in order to join forces to invest in sustainable connectivity across Europe and Asia. Our strategy is not a defensive reaction to any of our partners' respective connectivity strategies, such as China's Belt and Road Initiative, or Japan's or the United States' Free and Open Indo-Pacific strategies, but rather a timely opportunity to present formally the EU's own approach to connectivity, highlighting its assets, its experience and its willingness to cooperate with all Asian partners.

In the month of COP-24 in Katowice, EU-China cooperation on tackling the climate change has never been more important. The EU and China set our joint strong determination to implement the Paris agreement and make a success of COP-24, with the adoption of the Paris agreement implementation rules to move words to action. The EU and China cooperate closely on how to move to an energy and resource-efficient, low-carbon, circular, green economy. We are now working on 2050 strategies, including scenarios to get closer to staying within the 1.5 degrees warming. Our shared experiences with tackling climate change is extremely valuable as we look to protect nature and ecosystem services that support life with the next Biodiversity COP in 2020 in China and as we boost cooperation with China on moving to a circular economy.

There is a particularly strong case for closer cooperation on development, where China's shift from a beneficiary to purveyor of global goods over the last 40 years calls for

its efforts to be put on a par with other major providers, including the European Union. We must promote joint efforts to implement the 2030 Sustainable Development Agenda. Even if we come from different starting viewpoints, we can explore the possibilities of cooperation and find common fields of work that can be beneficial for all.

Third, the EU and China should increase work on international crises. Europe is a diplomatic, political, and security player and we have made lots of progress on defence in recent years. The meeting between HRVP Mogherini and the Chinese Defence Minister last year, as well as the visit of General Kostarakos, Chairman of the European Union Military Committee to China in June 2018 lay solid foundations for more cooperation.

In recent years, China has become much more active on the global stage. It is a strong player with global ambitions, permanent member of the UN Security Council and supporter of peace-keeping operations. The European Union and China could act together on issues where our interests converge, particularly in the UN framework.

We need to closely work with China to continue implementation of the nuclear deal with Iran, that has been the result of twelve long years of diplomatic work in which China's has been and continues to be essential. It is a key element of the global non-proliferation architecture.

We need to further support the efforts to find a peaceful solution to the question of the Korean Peninsula. We have seen positive developments with regards to inter-Korean relations, the commitment to complete denuclearisation, and there is much international support for both for the inter-Korean reconciliation process as well as the dialogue between the DPRK and the United States.

We need to move from common aspirations to specific, targeted cooperation in foreign and security policy, including on the Middle East Peace Process, Syria, Libya, and Afghanistan. In Africa we already cooperate on the ground in Mali and in Somalia, where we are both present to fight terrorism.

There are of course many other issues upon which we must continue working together, also under the fourth pillar of our strategic agenda 2020: education and culture, science and technology, or facilitation of human mobility. We have just concluded the EU-China Year of Tourism - a concrete manifestation of cultural and economic diplomacy.

At the same time we need to learn to manage our differences. We are concerned by the situation in Xinjiang and continued detention of human rights defenders, the developments in the South China Sea, or the growing restrictions on freedom of expression including in Hong Kong. We know that the Chinese government does not share all our principles and values, and they know that we are in different places on some issues. But we recognise and understand each other's importance in shaping a more cooperative global order, and the need for tangible progress in the interest of the peace, prosperity and wellbeing of our citizens and of the world. ☺



H.E. Ambassador  
Nicolas CHAPUIS

## BIO

H.E. Ambassador Nicolas CHAPUIS is Head of the Delegation of the European Union to China. He is a French career diplomat, and served in a number of French embassies including in China, Singapore, Mongolia and Canada. Prior to heading the EU Mission to China, he was Senior Officer in the Policy Planning Department of the French Foreign Ministry (2017-2018).

# WRITE A NEW CHAPTER FOR CHINA-EU RELATIONS

**ZHANG MING**

HEAD OF THE CHINESE MISSION TO THE EUROPEAN UNION

**As the year of 2019 rang in, the College of Europe turns 70. As Chinese Ambassador to the EU, I would like to express warm congratulations and best wishes to the College.**

Seventy years ago, the College was born out of the ruins of the World War II, and has been a witness and promoter of European integration and solidarity ever since. Seen as the cradle of political elites of Europe, the College has, in the past 70 years, developed itself into a specialized institute that has produced a large number of outstanding graduates for the cause of European integration. It is known for its enterprising and innovative spirit and the value of diversity.

In the past 70 years, Europeans have made a strenuous effort to establish the Customs Union and the European Single Market that seeks to guarantee the free movements of goods, labor, capital and services, to launch the EU's common policies for trade, agriculture and fishery, and to set up the euro zone. All this has contributed significantly to lasting peace and shared prosperity in Europe and beyond.

Also seventy years ago, the People's Republic of China was founded after over a century of turmoil and turbulence. Forty years ago, China embarked on the path of reform and opening-up, which has greatly unleashed the development potential and market vitality. There has been a huge improvement in people's living standards, social conditions and national overall strength.

The history of China and Europe both illustrates that success hinges on finding the right path of development that suits one's own conditions.

China attaches great importance to Europe and supports European integration. It is a priority for China's diplomacy to develop relations with Europe. In 2003, China and the EU established the comprehensive strategic partnership. In 2014, Chinese President Xi Jinping paid a historic visit to the EU headquarters. The two sides agreed to forge the China-EU partnerships for peace, growth, reform and civilizational exchanges. It was during this visit that President Xi came to the College and delivered a major speech to chart the future course of China-EU relations. President Xi, referring to the Flemish meaning of Bruges as a bridge, called on China and Europe to perceive the world with equality, respect and love, and treat different civilizations with appreciation, inclusiveness and the spirit of mutual learning. This is the way, as President Xi put it, to promote mutual understanding and knowledge among the people of China, Europe and other parts of the world.

In the past 40-plus years since the start of China-EU diplomatic relations, the size of economic and trade cooperation has increased by more than 250 folds. Every year, our citizens make more than 7 million visits to each other's territory. Every week, more than 600 flights travel between our two sides. The China-EU express rail services have seen over 11,000 trips so far. Last year, we had a successful China-EU Tourism Year, which is expected to bring the number of mutual visits to a record high. In a nutshell, China and the EU enjoy increasing mutual trust and shared interests.

The China-EU relations are defined by three key features. First, strategic significance. The policy direction and position of China and the EU, as two major actors of the international community, have a crucial role in shaping global order. The China-EU relations go far beyond bilateral context and have a strategic and global dimension. Second, mutual benefit. China and the EU do not have fundamental clashes of interests or geopolitical conflicts. We are partners, not rivals. Third, comprehensiveness. China and the EU have over 70 dialogue mechanisms, covering a wide range of areas such as politics, economy and trade, security, culture, social affairs, science and innovation, ocean, environment, polar affairs, cyberspace, and digital affairs.

At the end of last year, the Chinese government published the third policy paper on the EU, setting out China's policy objective toward the EU and specific measures to enhance cooperation with the EU. China stands ready to work with the EU to synergize the Belt and Road Initiative and Europe's development initiatives, enhance cooperation in the area of global governance, such as climate change and WTO reform, explore the possibilities of cooperation in such emerging areas as digital economy, marine economy and circular economy.

China is striving to improve the quality of its development and is opening its door wider and wider. This will generate greater opportunities for Europe and other parts of the world to work with China in a joint pursuit of a better future.

In our world, uncertainties and instability remain pronounced. The multilateral trading system and the rules-based global order are being threatened by protectionism and unilateralism. It is of crucial importance for China and

the EU to approach cooperation and competition wisely from a global and strategic perspective, jointly uphold multilateralism and free trade, and promote openness and cooperation rather than isolation and confrontation. It is widely expected that an open, cooperative and predictable China-EU relationship could help offset global uncertainties.

The continued growth of China-EU relations call for greater intellectual support and more fresh ideas. In this regard, I appreciate the College for its strong devotion to the studies of China-EU relations. I have been to the Europe-China Research Center and the China Library on the Bruges campus. I have also read the research papers written by the College professors and students. Your contribution has played a helpful role in enhancing mutual understanding and cooperation between China and Europe.

We expect the College to further bring out its academic strength, and put forward more useful ideas for the promotion of China-EU relations. Chinese universities and research institutes will be interested to visit your campuses and conduct more academic exchanges. You are much welcome to send faculty members and students to China and see with your eyes what China is like. The Chinese Mission to the EU is always ready to provide facilitation in this regard.

I wish the College greater success and China-EU relations a brighter future. ☺



H.E. Ambassador  
ZHANG Ming

## BIO

H.E. Ambassador ZHANG Ming is Head of the Chinese Mission to the European Union. His career at China's Ministry of Foreign Affairs started in 1983, and served at a number of Chinese embassies including in Yemen, Oman, Israel and Kenya. Prior to heading China's Mission to the EU, he was Vice Minister of Foreign Affairs (2013-2017).



# COMMENTS ON EU'S PROPOSED REGULATION ON ESTABLISHING A EUROPEAN FRAMEWORK FOR SCREENING FDI: RIGHT LEGAL BASIS?

BIN YE

The European Commission published its legislative proposal on screening foreign direct investment (FDI) on 13 September 2017.<sup>1</sup> The European Parliament, the Council and the Commission have come to a provisional agreement on 6 December 2018.<sup>2</sup> The core of the proposal is to establish a new mechanism for screening inbound foreign investment at EU level, which enables the European Commission to screen investment from third countries on grounds of security or public order. While the proposal maintains existing national screening mechanisms of some EU Member States, such as Germany, France and Italy, it requires all Member States to cooperate with the Commission, including annually reporting and timely informing to the Commission. The Provisional inter-institutional agreement strengthens the role of the Commission in the proposed framework by including economic competitiveness or even xenophobic attitudes among its consideration factors, i.e. together with virtual infrastructure, water, health, media, real estate, energy storage, nanotechnologies, biotechnologies, and by conferring on the Commission the power to adopt delegated acts to expand or amend the so-called list of “projects and the programmes of Union interest”<sup>3</sup>.

The proposed regulation aims to respond to the security concerns caused by recently increasing Chinese investments in European countries. In his annual State of Union speech, Jean-Claude Juncker, the president of European Commission, stated – although without naming names of any third countries: “we are not naïve free traders. Europe must always defend its strategic interests. This is why to-

day we are proposing a new EU framework for investment screening. If a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed.”<sup>4</sup>

However, the proposed regulation raises issues in terms of legitimacy. First, it arguably is not based on the unquestionable legal basis that the proposal declares. Although the European Union has the exclusive competence on FDI under the Lisbon Treaty, the proposed mechanism will limit free movement of capital, which falls under shared competence between Member States and the Union and then follows different legislative procedures. In addition, a shifting legal basis as such thus possibly creates a legal vacuum.

## **1. Legal basis: common commerce policy or free movement of capital?**

The European Union acquired the exclusive competence in the field of foreign direct investment under the Lisbon Treaty, which came into effect in 2009. According to the proposal, Article 207 TFEU is taken as the legal basis for the EU to establish the screening FDI mechanism.<sup>5</sup> However, the proposed screening FDI mechanism also deals with free movement of capital in the internal market and security issues, where the former belongs to shared competence between the Union and the Member States, and the latter

belongs to the exclusive powers of Member States. Under the founding treaties of the European Union, the competences of EU institutions are limited by the conferral of the Member States. A question follows, if a proposed regulation is dealing with different competences, which one is its right legal basis?

The case law of the EU Court of Justice has developed test in two steps to decide whether a certain act falls within the common commercial policy. The first step is to decide whether it belongs to EU's external action. As set out in Article 207(1) TFEU, the common commercial policy "shall be conducted in the context of the principles and objectives of the Union's external action". As interpreted by the Court, the common commercial policy relates to trade with third States. The second step is to determine whether it is essentially intended to promote, facilitate or govern such trade and has direct and immediate effects on it.<sup>6</sup> However, it seems that the EU proposal for creating FDI screening framework can hardly pass the first test because it does actually deal with the internal market, where inward FDI's participate in operations within and have direct and immediate effects on. As the European Commission admitted in its Communication on Sovereign Wealth Funds in 2008, "one of the main goals of EU trade policy is to open third country markets to EU investors, on the basis of the same principles used to govern the internal market." In other words, the common commercial policy is intended to promote outward FDI, while the inward FDI is governed by the rules of the internal market. Under this interpretation, the potential conflicts between the two sectors are easily solved. Therefore, the appropriate legal basis of the EU screening FDI mechanism should be Article 64 TFEU. Whereas the free movement of goods and persons merely apply to movement between the Member States, the principle of free movement of capital also applies to the relations between member states and third countries.<sup>7</sup> This unilateral commitment to open the EU market does not required reciprocity under the founding treaties of the

EU. Article 64 (2) and (3) of TFEU provide for two legislative procedures to manage or limit FDI on EU level, but were never put in practice, thus being sometimes referred as "sleeping beauty".<sup>8</sup>

Choosing paragraph 3 of Article 64 TFEU as a legal basis would undoubtedly send a signal that the EU is stepping back from its commitment to an open investment regime. Indeed, according to this paragraph, "only the Council, acting in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries". In other words, the proposal should be adopted with the special legislative procedure, which requires unanimity among Member States and limits the involvement of the European Parliament.

Instead, according to Article 64 (2), "the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, adopt the measures on the movement of capital to or from third countries involving direct investments — including investments in real estate — establishment, the provision of financial services or the admission of securities to capital markets". If the proposal is appropriately amended, paragraph 2 would therefore enable EU institutions to manage and supervise the inbound FDI in accordance with EU law.

## 2. Exclusive Competence or Shared Competence?

If a policy area belongs to the EU's exclusive competence, generally speaking, Member States have no right to retain their existing mechanisms in place except for special situations, such as in a transition period. Under this perspective, since the proposed legislation maintains the existing national screening mechanisms rather than replacing them, it looks that in its reasoning Member States have inherent competence to screen FDI. In addition, the provisional agreement restates that the regulation is without prejudice to the sole responsibility of the Member States for the maintenance of national security and to the right of the Member states to protect their essential security interests. It is easy to understand that radically replacing national mechanisms would face strong opposition from the Member States as long as the competence concerned does actually belong to them. Given though that Member States admit the EU has exclusive competence on screening FDI mechanism, this means that the existing national mechanisms will continue operate upon permission of EU institutions and will be replaced later on.

**ONE OF THE MAIN GOALS OF EU TRADE POLICY IS TO OPEN THIRD COUNTRY MARKETS TO EU INVESTORS, ON THE BASIS OF THE SAME PRINCIPLES USED TO GOVERN THE INTERNAL MARKET**

Nevertheless, mechanisms relating to the FDI do not necessarily fall within the EU's exclusive competence because FDI might be merely ancillary to the screening mechanism. In May 2017, the Court of Justice of European Union ruled that the approval of provisions on Investor-State dispute settlement of EU-Singapore FTA does not fall within the exclusive competence, but within a shared competence.<sup>9</sup> The reasoning of the Court is to determine whether lifting the jurisdiction of national courts on investment disputes is of a purely ancillary nature, within the meaning of its case law. In the case of the FDI screening mechanism, considerations on security are not ancillary, but rather at its core. It can be inferred that the screening mechanism closely concern national security policies, which fall into the competence of the Member States. If there are no other persuasive arguments, the legal basis of the proposed regulation could hardly be supported by the reasoning of European Court of Justice.

Understanding what kind of experts will be involved in screening FDIs might help understand the nature of the competence. It is hard to imagine that a pure investment expert is also competent on the security issue. Vice versa, someone who has expertise on defence or security may lack a comprehensive knowledge on investments.

### **3. Inconsistency with the European Commission's earlier position on Sovereign Wealth Funds**

Comparing the Commission's position on Sovereign Wealth Funds (SWFs) of 2008<sup>10</sup> with the proposal under discussion, it can be found that the Commission's legal analyses and reasoning are not consistent. SWFs are generally deemed as state-owned investment vehicles, which are indirect investors in most cases but can also control or manage companies in some (i.e. FDI). It is very hard to suppose that drafters of the Common European Approach to Sovereign Wealth Funds had not noticed that FDI were included into the common commerce policy after the Lisbon Treaty.

In the Communication of 2008, the Commission considered that "with regard to the EU legal framework, investment by SWFs in the EU are subject to the same rules and controls as any other form of investment, either foreign or domestic, where the principles of free movement of capital between Member States, and between Member States and third countries stipulated in Article 56 EC apply. The free movement of capital is not absolute. As a fundamental principle of the Treaty, it may be regulated in two respects at the European level under Article 57 (2) EC: first, the Community may adopt by qualified majority measures on the

movement of capital from third countries involving direct investment; Second, it is not excluded that the Community can introduce – by a unanimous decision – measures that restrict direct investment." As it is very clear, the Commission declared that any measures that restrict direct investment should be based on former Article 57 (2) EC, currently Article 64 (3) TFEU.

In order to respond to the various suggestions made by the stakeholders, such as the introduction at EU level of a committee on foreign investments on the US model, a screening mechanism or "golden shares" for foreign investment, the 2008 Communication noticed they would mean "run[ing] the risk of sending a misleading signal – that the EU is stepping back from its commitment to an open investment regime. They would also be difficult to reconcile with EU law and international obligations".

If the FDI screening proposal is eventually adopted by the EU institutions, the Commission's position on the SWFs of 2008 would be disowned. For these reasons, EU legislators should explain why Article 64 TFEU was not chosen as the legal basis and justify the compatibility of the FDI screening mechanism with EU law and international obligations.

### **4. Legal vacuum from 2009 to 2019?**

Article 65 (1) b TFEU provides the important "security exception" to the principle of free movement of capitals, which is well recognised as the legal basis of those domestic frameworks that were put in place for reviewing inward foreign investment by some Member States, such as Germany. Article 4.4 of Foreign Trade and Payments Act of Germany provides that "in foreign trade and payments transactions, legal transactions and actions can be restricted [...] in order to guarantee the public order or security of the Federal Republic of Germany within the meaning of Articles 36, 52(1) and Article 65(1) of the Treaty on the Functioning of the European Union".

As long as the EU proposal for a FDI screening mechanism does not draw legitimacy from the chapter of free movement of capital but from the common commercial policy, it would pose another legal problem. In fact, given that the investment review mechanisms put in place by Member States have been built on the wrong legal basis since the Lisbon Treaty came into force, their screening decisions would be invalid since then.

According to Article 2 (1) TFEU, "when the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts,

the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts". If the FDI screening mechanism belongs to the exclusive competence of the European Union and the proposal enters into force in 2019, the Member States' investment review mechanisms could be deemed as not being empowered by the Union over the ten years. This kind of interpretation thus may question the decisions made by national screening authorities.

## Conclusion

All in all, it is understandable why the Commission did not choose the free movement of capital but the common commercial policy as the proposal's legal basis. Exclusive competence attributed under the latter contribute to expand the roles of the European Commission and European Parliament, as happened with the inter-institutional provisional agreement, and facilitate further centralisation of

domestic investment review mechanisms. The European Commission might not be willing to admit the regulation constituting "a step backwards in EU law as regards the liberalisation of the movement of capital to or from third countries". However, the side effects of choosing the wrong legal basis also appear to be troublesome. Therefore, EU legislators should explain the compatibility of the proposed regulation with EU law and international obligations. The legal vacuum arguably caused by the shifting legal basis of national security review mechanisms equally needs to be resolved. ©

**1** Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, 2017/0224 (COD), COM(2017) 487 final, Brussels, 13.9.2017. **2** Provisional Agreement Resulting from Interinstitutional Negotiations, PE631.953v01-00, 6.12.2018. **3** Having taken account of the differences between the two, for the purpose of this article the European Commission's proposal and the provisional inter-institutional agreement will be hereafter equally indicated as "the proposal" or "the proposed regulation", if not stated otherwise. **4** European Commission - Press release, State of the Union 2017 - Trade Package: European Commission proposes framework for screening of foreign direct investments, Brussels, 14 September 2017. **5** Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, 2017/0224 (COD), COM(2017) 487 final, Brussels, 13.9.2017, p. 8. See also, Preamble 6, Provisional Agreement Resulting from Interinstitutional Negotiations, PE631.953v01-00, 6.12.2018, p. 4. **6** See Opinion 2/15 of the Court (Full Court), 16 May 2017, ECLI:EU:C:2017:376, paragraph 33-36. **7** See Article 63 TFEU. **8** Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law*, Oxford University Press, 2009, pp.304-305. **9** Opinion 2/15 of the Court (Full Court), 16 May 2017, ECLI:EU:C:2017:376, paragraph 293. **10** Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Common European Approach to Sovereign Wealth Funds, Brussels, 27.2.2008, COM(2008) 115 final, at. 3.1, p. 5.



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# CHINESE INVESTMENT TO SERBIA AND EU-CHINA RELATIONS

JING MEN

## Introduction

In recent years, Serbia has been attracting an increasing amount of Chinese investment, which reached around \$6 billion by the end of 2017.<sup>1</sup> The Chinese government has actively promoted the Belt and Road Initiative in the Balkans, with the purpose of building a land-sea express passage way linking the Piraeus port and Budapest in order to speed-up transportation between China and Europe.<sup>2</sup> Therefore, Serbia is an important destination of Chinese investment. Yet, such initiative stoke concern in the EU. In July 2018, European Commissioner Johannes Hahn told Politico's EU Confidential podcast that China's growing role in the Western Balkans could turn countries of the region into Trojan horses that would one day become EU members.<sup>3</sup>

Trojan horses imply malicious behaviour intending to undermine or destroy from within. As Commissioner Hahn interprets China's influence on the Balkan countries so negatively, he obviously regards China as a foe to the EU. In recent years, several European officials have labelled China as a "threat". Donald Tusk, President of the European Council, in his letter to the member states before the Malta summit in January 2017, listed China as one of the first threats to Europe.<sup>4</sup> In April 2018, German newspaper Handelsblatt reported that 27 EU ambassadors out of 28 signed a document criticising China's Belt and Road Initiative as a potential threat to the EU.<sup>5</sup> In November 2018, French President Emmanuel Macron called for the creation of a European Army and for it to have the defence against China as one of its objectives.<sup>6</sup> As a reaction to Tusk's remark, Xinhua News Agency published a commentary on 2 February 2017, arguing that China is an "opportunity", not a

threat.<sup>7</sup> After Macron's speech in November 2018, Chinese foreign ministry spokesperson responded by saying that China "had never posed a threat to Europe".<sup>8</sup>

While the European side is much agitated by China, the Chinese side has not realised what is not working. This paper will first look at Chinese investment in Serbia and then at what challenges the EU faces there. The last part of the paper will examine whether the EU and China are foes in Serbia or whether they can work together.

## Chinese investment to Serbia

Over the last couple of years, China has become an important investor in Serbia, particularly in its road and rail infrastructure and metallurgy. Serbian President Aleksandar Vučić was in Beijing in September 2018 and signed agreements worth \$3 billion, including \$900 million with the China's Shandong Linglong Tire Co to build a factory in Zrenjanin, \$1.46 billion in the Serbian RTB-Bor mines, and other agreements on infrastructure projects. Vučić said that Serbia has become "the port for Chinese investments throughout the region" and Chinese President Xi said that Serbia is a "good, honest friend, and good partner".<sup>9</sup>

China's good relationship with Serbia can be dated back to the late Cold War period. Just after the Chinese Cultural Revolution was over, Tito was invited to visit Beijing in 1977.<sup>10</sup> China supported former Yugoslavia during the Kosovo War and opposed NATO airstrikes in Serbia. The Chinese Embassy in Belgrade was bombed by the US in 1999 and three Chinese journalists were killed. In the 21st century, Beijing-Belgrade economic relationship has been further growing, and it was stimulated by China's Belt and



Road Initiative. On 18 December 2014, Chinese Premier Li Keqiang visited Serbia and attended the opening ceremony of Pupin Bridge, a Chinese-built bridge, and also China's first big infrastructure investment on the European continent. In June 2016 during the visit of Chinese President Xi to Serbia, the two sides upgraded their relationship into a comprehensive strategic partnership.

For the moment, a number of projects by Chinese investors are ongoing in Serbia, including: modernising the Kostolac thermo-power station, building a zinc oxide factory in Zrenjanin, opening a tyre factory in Zrenjanin, copper smelting and mining in Rudarsko Topionicki Basen Bor, investing in steel mill Zelezara Smederevo, construction of an industrial park in the Belgrade suburb of Borca, building of highway that connects Serbia with Montenegro, modernising and rebuilding of the Belgrade-Budapest high-speed rail link in the territory of Serbia, etc.

Why has Chinese investment been growing so fast in Serbia? Apart from the above mentioned good historical relationship between Beijing and Belgrade, Serbia's geographical location is a very important factor for consideration. Situated in the Western Balkans, Serbia serves as a natural corridor to connect Southern and Eastern Europe with Central Europe. China is very interested in pushing Hungary-Serbia railway into operation and thus saving time and cost in reaching the markets of Central Europe. Furthermore, Serbia's candidate status to the EU is another important reason. Serbia received the full candidate status in 2012, and would probably join the EU in 2025.<sup>11</sup> In order to prepare for the accession, Serbia has been continuing to align its legislation with the EU acquis. As reported by the European Commission, Serbia has a good level of preparation in areas such as company law, intellectual property, science and research, education and culture, and customs, but needs to address issues of non-compliance with the Stabilisation and Association Agreement, particularly regarding restrictions on capital movements, state aid regulation, etc.<sup>12</sup> In the author's interviews in Belgrade, several Chinese companies frankly expressed their desire of learning EU rules by investing in Serbia. Their idea is to learn by doing and to take Serbia as a testing field. Belgrade's adaptation to EU rules and preparation for EU membership thus is ideal for Chinese companies to learn and to practise EU rules. Another advantage for Chinese companies to invest in Serbia before it joins the EU is to take Serbia as a gateway to enter European market and to get treated as local Serbian companies once the country gains the EU membership.<sup>13</sup>

When Chinese companies invest in the EU and its neighbouring countries, they are often criticised for employing Chinese workers and for lacking transparency.<sup>14</sup> This is also the case of Serbia. Yet, in one of the interviews with professor Mitrović from University of Belgrade, she explained that while the Serbian public opinion is unhappy with the current state of affairs and would prefer a more visible spill-over on the local economy, even larger Serbian companies lack the necessary technical and financial capacity to manage complex projects by themselves, but only engage into subcontracts.<sup>15</sup>

In an official survey in Serbia on its top investors, China is perceived very positively. Srdjan Bogosavljevic, head of the IPSOS Strategic Marketing consultancy in Belgrade, said that "it has reached a very high level probably because investments from China are presented or communicated as a gesture of good will."<sup>16</sup>

### **The EU's influence in Serbia facing challenges**

Historically, relations between Brussels and Belgrade have been rather bumpy. In 2008, their relationship was institutionalised thanks to the signing of the bilateral Stabilisation and Association Agreement (SAA). However, in the past decade, the perception on the EU in Serbia has not noticeably improved. A report published by the European Parliament in 2017 pointed out that the EU's influence was evaluated as positive by only 28 percent of Serbians, while 36 percent evaluated it as negative. Serbians are the least pro-EU state in South-East Europe, only 26 percent of them considering EU membership positively.<sup>17</sup>

The EU's lack of influence in Serbia may be due to a number of reasons. Firstly, enlargement is no longer a priority issue for the EU, rather it is a burden for the its budget and institutions. Candidate countries, including Serbia, are seen as unstable and questioned on whether they share European values.<sup>18</sup> In order for Belgrade to join the EU, it needs to converge with European values and EU institutions. Yet, "Stability over democracy" is the mantra of the Serbian government.<sup>19</sup>

Secondly, the length of accession has negatively affected the public perception. Up until now, negotiations with Serbia have opened 14 chapters and provisionally closed only two, while 19 chapters remain unopened.<sup>20</sup> 38 percent of Serbians interviewed in a survey believed that their country would never be able to join the EU, and only 18 percent thought that the accession could be realised by 2025. 28 per cent of the respondents even considered that EU membership as a bad thing.<sup>21</sup> The EU ambassador to Ser-

bia acknowledged a weakness in connecting with Serbian people and pledged to make efforts to strive for more visibility.<sup>22</sup> The Head of the Negotiation Team for Accession of Serbia to the EU also pointed out that lots of prejudice and misunderstanding exist between Serbia and the EU, as they are framed with the perceptions and memories from the 1990s.<sup>23</sup>

Thirdly, Kosovo remains a thorny issue. Kosovo declared independence in 2008, but is not recognised by Serbia. A number of EU member states, including Romania, Cyprus, Greece, Slovakia, and Spain do not recognise Kosovo either. In order to pave the way for its EU membership, the Serbian government agreed to exchange ethnic enclaves in a territorial swap with Kosovo. Although the US and the EU back this idea, it also causes serious concerns, as it would risk “emboldening Albanians in Macedonia and Croats and Serbs in Bosnia to try to redraw borders”,<sup>24</sup> and would risk even “a new war”.<sup>25</sup>

Finally, the EU is challenged by China and Russia in Serbia. As Vučić said at the Belgrade Security Forum (2018), “the Balkans are a chessboard of great powers”.<sup>26</sup> Serbians believe that their interests are best served by maintaining good relations with Russia (94 per cent of respondents), with China (89 per cent of respondents) and with the EU (71 per cent of respondents).<sup>27</sup> According to a survey conducted by Belgrade Centre for Security Policy in 2017, when asked what foreign country had a positive influence on Serbia, 61 percent of the respondents indicated Russia, 52 percent replied China, whereas only 28 percent indicated the EU.<sup>28</sup> Although four of the five biggest investors in Serbia come from the EU, Serbians think China and Russia are among the top ones.<sup>29</sup> As a matter of fact, the EU is the biggest donor (with €3.688 billion in grants) and the largest lender (with more than €4.3 billion worth of loan agreements) to Belgrade, whereas Serbia is “one of the biggest recipients of EU funds in the world”.<sup>30</sup> Yet, in competing for influence in Serbia, all the results of the surveys mentioned above demonstrate that “perception trumps reality”.<sup>31</sup> While the balance of power may be a normal game in Serbia, what is unusual for the EU is that the country is “in an unstable equilibrium”.<sup>32</sup> The EU introduced sanctions against Russia over the Ukraine crisis and up until now, these sanctions have not been lifted and the Ukraine issue is yet to solve. Russia is regarded as a serious security threat to Europe.<sup>33</sup>

To a certain degree, Serbians’ positive perception on Russia may have a negative impact on the EU’s efforts to raise its profile in Serbia. Furthermore, China’s rapidly increasing investment leads to an increasing influence in the country, which somehow also constitutes another challenge for the EU. The EU is afraid that these positive perceptions on third actors may “undermine the idea that that the EU is the region’s best and only hope”, and erode “popular consent for the painful reforms needed to qualify for the EU entry”.<sup>34</sup> But are the EU and China pure competitors in Serbia? Can they work together? The next part will try to answer these questions.

### Can the EU and China work together in Serbia?

According to a recent analysis, the EU and China have different interests and comparative advantages in Serbia, with the former being stronger in the rule of law and aid and the latter in infrastructure and markets.<sup>35</sup> In recent years, China has attracted more criticism from the EU

due to a number reasons. First, China has a totally different political system and is in favour of a set of values which are different from those promoted by the European Union. The West had expected, via engagement with China, to help transform the latter

into a democratic, civil society based on the rule of law, with respect to human rights, but got disillusioned and disappointed.<sup>36</sup> China’s economic growth and increasing influence in Serbia makes the EU afraid that this would be at the sacrifice of its own influence.

Under the leadership of President Xi Jinping, it is clear that the path China is taking diverges from that of the EU. While some Chinese policies and initiatives give problems to the EU and its member states, and China is increasingly perceived as a competitor, there is no doubt that the Brussels needs to work with Beijing in global governance and regional peace and development in Europe and Asia.

The EU’s most recently published policy paper on China says very clearly that “[the] EU’s engagement with China should be principled, practical and pragmatic, staying true to its interests and values”.<sup>37</sup> The ongoing Serbian reforms to adapt to the EU acquis will not only help promote the EU political and economic model in the country, but also provides an opportunity for Chinese companies to have experience on market reform which may have spill-over

## THE EU IS THE BIGGEST DONOR AND THE LARGEST LENDER TO BELGRADE, WHEREAS SERBIA IS “ONE OF THE BIGGEST RECIPIENTS OF EU FUNDS IN THE WORLD”

effects upon fellow companies. In the long run, such learning experience gained by the Chinese companies may be beneficial to the overall EU-China economic relationship.

Secondly, China has been pushing forward a number of initiatives, including the 16+1 forum, which is suspected to be used to 'divide and rule' the EU.<sup>38</sup> Serbia is one of the 16 countries in this forum, and one of the five non-EU member states. The Belt and Road Initiative is equally criticised due to its lack of transparency and non-market practice. According to the author's interview in Beijing, the China-led 16+1 forum, which has triggered negative reaction from the EU, may probably be adjusted in terms of the frequency of the summits (once every two years instead of annually) and developed bilaterally between China and these 16 countries.<sup>39</sup> In the most recently published China's policy paper on the EU, the Chinese government pledges that "the Belt and Road Initiative follows the principle of consultation and cooperation for shared benefits, up-

holds openness, inclusiveness and transparency, observes international rules and market principles, and pursues high quality and high standards tailored to local conditions".<sup>40</sup> Although it is still to see how Beijing will perform in the 16+1 forum and further promote the Belt and Road Initiative in Europe in the coming months, at least it hears the complaints from the EU and takes them into consideration when making new policies.

Between the EU and China, there have been more than 60 dialogue on different subjects and at different levels. Yet, no regular dialogue is attributed to the Belt and Road Initiative, the 16+1 forum, or the Balkan countries. Brussels and Beijing should consider establishing such dialogue(s), which may help enhance direct and frank exchange and understand each other's core interests. In this way, both the EU and China can give full play to their comparative advantages and explore cooperation in Serbia. ©

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