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**E2 Public Seminar**  
**CELIS Forum on Investment Screening (CFIS)**  
**Uppsala University**  
**1-3 June 2022**

**Report by Dr Naoise McDonagh. Institute for International Trade, The Centre of Excellence in International Trade and Global Affairs**

CFIS 22 is Europe's first and foremost forum to discuss questions on investment screening and security. It brings together EU officials, national experts, diplomats, academics, business leaders, think tankers, and representatives of civil society and the media from across Europe and beyond.

Dr McDonagh was invited to present on transformations in EU-China relations in recent years, due to tensions over China's state-led economic policies and increasingly assertive geopolitical policies.

Dr McDonagh outlined the EU's new investment screening regulation as one policy response to these tensions. He outlined a 'threats-based' framework for gauging whether controversial elements of the EU's Regulation concerning national security and public order as justifications for screening were excessive or reasonable. Dr McDonagh provided evidence to support the latter, thus contributing to an important EU-wide debate on investment screening.

Dr McDonagh has been invited to contribute a chapter outlining his analysis to an academic book on EU foreign investment screening.

<https://www.celis.institute/events/celis-events/home-celis-2022/>

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# Protection or Protectionism? Why China's "socialist" market economy justifies EU investment screening measures



**Dr Naoise McDonagh, Institute for International Trade, University of Adelaide,  
and President of the Australian Institute of International Affairs, South  
Australia**

**Presented at the CELIS Annual Forum, Uppsala University**

**2 June 2022**

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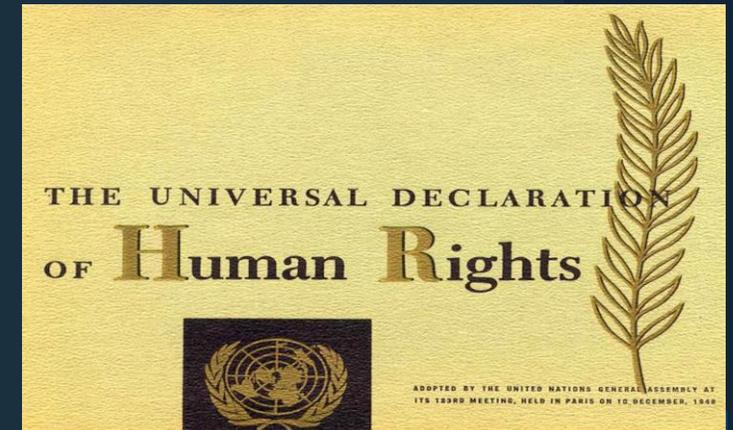
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# Some Brief Historical Context: From “Engagement” (1990s-2017) to “Systemic Rival” (2017-present): The Realignment of EU-China Relations

**1: Geopolitics: Great power rivalry**

**2: Economics: Systemic rivalry**

**3: Values: Conflicting social and political values**



# Historical Context for China-West Trade Relations: The Original ‘Engagement Strategy’

The original Engagement Strategy was based on the idea that:

- ‘deepening commercial, diplomatic, and cultural ties would transform China’s internal development and external behaviour’ (Campbell and Ratner, 2018, p.60).
- Also termed “Wandel durch handel” – change through trade

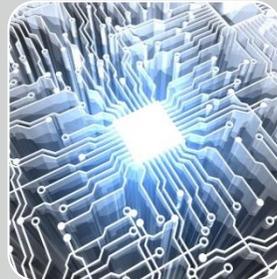
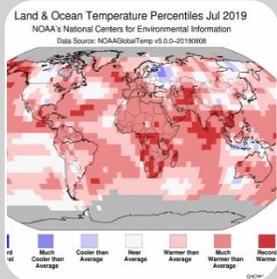


## China enters the WTO in 2001



# EU & Systemic Economic Rivalry

- The European Commission's *EU-China Strategic Outlookpaper* (2019) shifted to a quadripartite understanding of EU-China relations:



1.  
Cooperation  
Partner with  
common  
objectives

2.  
Negotiation  
partner  
seeking a  
balance of  
interests

3.  
Economic  
competitor  
seeking  
techno  
leadership

4.  
Systemic Rival  
promoting  
alternative  
modes of  
governance



# Part 2: Risks Emerging from Economic System Rivalry



**Foreign Direct Investment: Opportunity, Risk and Response**



# FDI Opportunity: EU is a principally open economy

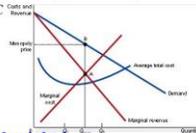
- ❖ Longstanding preference for minimal foreign direct investment (FDI) restrictions
- ❖ Free capital flows enshrined in Treaty on the Functioning of the EU (TFEU, art. 63)
- ❖ OECD's FDI Regulatory Restrictiveness Index highlights high openness of Members



## Allocative Efficiency

- Total Welfare is maximized only when  $MC = MB$  for society
  - Since  $MB = Price$  => only when  $Price = MC$

- **Allocate efficiency** is when  $P = MC$



- Any other production point produces **deadweight loss**
  - Monopolies are **not allocatively efficient** ( $P > MC$ )
  - Competitive firms are ( $P = MC$ )

**FDI Risk:** political influence, strategic tech transfers, unfair competition

“concerns have recently been voiced about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons.

EU investors often do not enjoy the same rights to invest in the country from which the investment originates.” (EU Commission 2017)



# **FDI Risk Response: a new approach to EU-wide FDI screening**

- ❖ **September 2017 the EU Commission proposed a Regulation on establishing a common framework for screening FDI**
  - ❖ the Regulation was initially met with some concerns/scepticism
  - ❖ ultimately, however, it was adopted relatively quickly (March 2019), coming into effect on 11 October 2020



# The Regulation: its scope and aim

- ❖ Its function is to provide an EU-wide coordinating mechanism designed for collaboration, information sharing and cooperation – **casting a light on block-wide screening**



# Controversy over ‘security’ and ‘public order’ terminology

- ❖ ‘In accordance with this Regulation, Member States may maintain, amend or adopt mechanisms to screen foreign direct investments in their territory on the grounds of *security* or *public order*’ Article 3(1)

# Part 3: China's Socialist Market Economy



**Is the Regulation fit for purpose in protecting against state-driven investment risks?**



# Party Leadership is Hallmark of Chinese Political System

The Party

The State

Civil Society

The Market

**Xi Jinping, 2017:**

“The Party exercises overall leadership over all areas of endeavour in every part of the country... We must improve the institutions and mechanisms for upholding Party leadership”, **19<sup>th</sup> Party Congress keynote speech**



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# Rule-of-law, or, Rule-by-law?

## The CCP's Party Constitution:

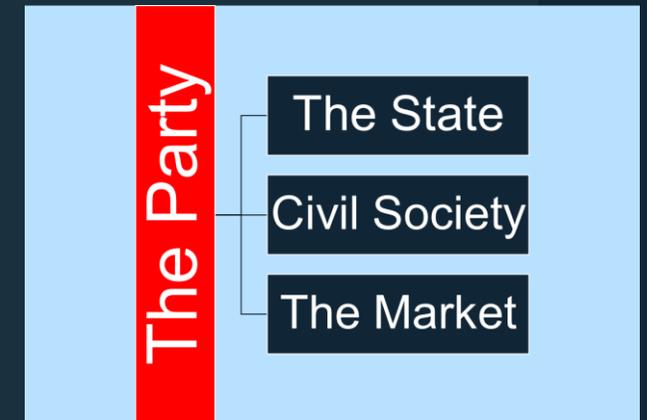
- ❖ states the CCP must “develop a socialist rule of law system...and build a socialist rule of law country”
- ❖ declares that “The Party must act within the scope of the country’s [State] Constitution and the law”

## Constitution without constitutionalism

- ❖ a formal system of rules is enacted for governance and bureaucratic efficiency – i.e. **rule-by-law**
- ❖ “We should resolutely resist erroneous influence from the West: 'constitutional democracy,' 'separation of powers' and 'independence of the judiciary,“ – Chief Justice Zhou, 2017

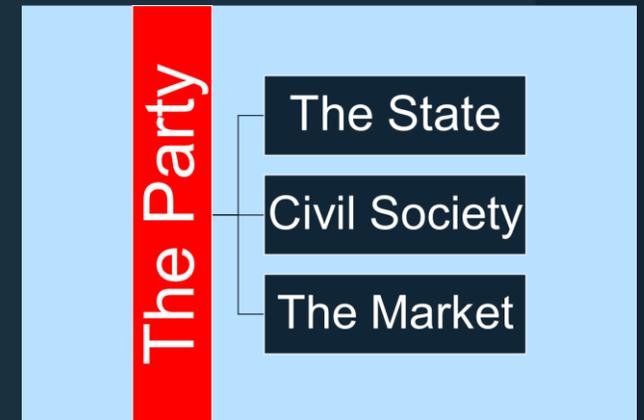
# Xi's Political Reform Agenda

- ❖ 2013 Party membership is 85 million; by 2021 membership is 95 million
- ❖ Xi's reforms strengthen ideology and Party discipline
- ❖ Strict use of *nomenclatura* system for judicial and SOE leadership appointments
- ❖ Reinvigorating Party cell system in private firms
  - ❖ By 2017 1.88 million private firms had created such cells, a figure representing over 73 percent of all private firms (Pearson, et al., 2021, p. 209).
- ❖ Difficult if not impossible to mark where Party influence ends and firm autonomy begins



# The Party as 'Investor State'

- ❖ the Party evolved beyond its position as *owner* and *regulator* within the economy, to take on the role of *core investor* in the private sector
- ❖ *Assessed ownership structure of 18.45 trillion RMB managed by large asset management entities - state-owned central and local level entities managers accounted for 91%, private entities 9% (Chen & Rithmire, 2020)*
- ❖ Provides the CCP mechanism for *policy channelling*



# In Conclusion

Economic connections a source of vulnerability

China's political economy poses unique risks

Flexible policy tools, e.g. EU Screening Regulation, are necessary

# New Geo-economic Era





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