Chinese Foreign Direct Investment in the European Union: An Empirical Analysis

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Abstract

In recent years, Chinese foreign direct investment (FDI) has been exacerbating fears in the European Union (EU). While Chinese FDI stock in the Bloc has been declining for the past two years, it is increasingly concentrated in sectors that are considered strategically important by the EU. The EU has no harmonised FDI policy, but as a response to growing anxieties, the European Commission has put forward a non-mandatory FDI screening framework specifically to address Chinese FDI inflows. The mechanism goes into effect in 2020. To address the EU's fears about Chinese investments with efficient policies and to identify wanted and unwanted investments, it is crucial to understand the determinants of Chinese FDI flows to the EU. This thesis employs panel data analysis to investigate these determinants, using data from between 2003 and 2018. My results show that the number of patent applications in the host country has a positive significant impact on Chinese FDI inflows, while FDI restrictions have a significant negative impact. Market growth, political stability, corruption control, and trade relations are statistically insignificant. This thesis contributes to the literature with up-to-date empirical estimations and consideration for recent political developments such as the new EU FDI screening framework, shifting Chinese investment strategies, and rapidly deteriorating EU-China relations.

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List of Abbreviations

FDI – Foreign direct investment
EU – European Union
SOE – State-owned enterprise
M&A - Mergers and acquisitions
MNE – Multinational enterprise
BRI – Belt and Road Initiative
ITC - Information and communications technology
AEI - American Enterprise Institute
CEE – Central and Eastern Europe
WGI - Worldwide Governance Indicators
CFIUS - Committee on Foreign Investment in the United States

Introduction

In recent years, Chinese foreign direct investment (FDI) inflows to the European Union (EU) have been the subject of growing concerns. Chinese takeovers of companies in strategically important sectors have been dominating the European political and security discourse. As concerned voices have been growing louder, questioning whether these investments should be allowed, the EU has proceeded to toughen its stance towards China.

Brussels has taken a number of steps implying that if necessary, it is willing to move towards a European brand of economic nationalism to fend off the threat of these investments.[1] In 2019, the European Commission announced a new FDI screening framework, aiming to create a cooperation mechanism between member states to share information about potentially problematic investments in the EU. The framework will go into effect in October 2020 and will mainly seek to halt Chinese investments in the Bloc, targeting strategic sectors or originating from SOEs.[2]

Fears about Chinese investments, coupled with the perception that they are overflowing the EU, make these capital flows seem all the more threatening. In reality, Chinese FDI stock in the EU has been declining since 2017.[3] This is on the one hand due to the EU becoming more conscious of the potential downsides of these investments. On

[1] Zettelmeyer, Jeromin. 'The Troubling Rise of Economic Nationalism in the European Union'. Peterson Institute for International Economics (PIIE), 29 March 2019, accessed 9 December 2019, https://www.piie.com/blogs/realtime-economic-issues-watch/troubling-rise-economic-nationalism-european-union.
[2] European Commission. 'Foreign Investment Screening: New European Framework to Enter into Force in April 2019', 5 March 2019, accessed 11 October 2019, https://europa.eu/rapid/press-release_IP-19-1532_en.htm.
[3] Kratz, Agatha, Mikko Huotari, Thilo Hanemann, and Rebecca Arcesati. 'Chinese FDI in Europe: 2019 Update'. Mercator Institute for China Studies (MERICS), April 2020, accessed 29 April 2020, https://www.merics.org/sites/default/files/2020-04/MERICS-Rhodium%20Group_COFDI-Update-2020_2.pdf.

the other, because Chinese investment stock has been declining globally since 2016.[4] Growing concerns about capital outflows and depreciation of the Chinese renminbi have prompted Beijing to consider curbing FDI outflows in 2016.[5] Accordingly, they introduced new measures to decrease capital outflows and adopted a new outbound FDI regime in 2017.[6]

The decline does not mean that the EU should not pay close attention to Chinese investments in the Bloc. Right now, the European Commission's cardinal problem is not the scale of investments but where they are targeted.[7] Throughout the 2010s, Chinese investments became less diverse, and by 2019, 80 per cent of Chinese FDI in the EU was concentrated into four sectors: consumer products and services, automotive, information and communications technology (ITC), and financial and business services.[8] Transportation, ITC, and finance are critical sectors as a whole, and consumer products and services additionally include several critical sectors.[9]

It is clear that debates about Chinese investments in Europe will not fade from the public discourse. FDI is a good target for research since there are always new angles from which to approach swiftly changing investment flows. While the topic of Chinese FDI in Europe has been covered in the literature, it needs to be discussed from fresh angles with

[4] Ibid, 8.
[5] Kirkegaard, Jacob Funk. 'Chinese Investments in the US and EU Are Declining—for Similar Reasons'. Peterson Institute for International Economics, September 2019, accessed 22 May 2020, https://www.piie.com/sites/default/files/documents/pb19-12.pdf.
[6] State Council of the People's Republic of China. 'Guojia Fagaiwei Youguan Fuzeren Jiu "Guanyu Jinyibu Yindao He Guifan Jingwai Touzi Fangxiang de Zhidao Yijian" Da Jizhe Wen 国家发改委有关负责人就《关于进一步引导和规范境外投资方向的指导意见》答记者问 [Person in Charge at the National Development and Reform Commission Answered Questions from Reporters Regarding the "Guiding Opinions on Further Guiding and Regulating the Direction of Overseas Investment"]', 18 August 2017, accessed 18 May 2020, http://www.gov.cn/zhengce/2017-08/18/content_5218794.htm.
[7] European Commission. 'EU-China – A Strategic Outlook', 12 March 2019, accessed 23 August 2019, https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf.
[8] Kratz et al., 'Chinese FDI in Europe: 2019 Update', 13.
[9] European Parliament. 'EU to Scrutinise Foreign Direct Investment More Closely', 14 February 2019, accessed 9 May 2020, https://www.europarl.europa.eu/news/en/press-room/20190207IPR25209/eu-to-scrutinise-foreign-direct-investment-more-closely.

the new FDI screening framework, shifting Chinese investment strategies, and rapidly deteriorating EU-China relations in mind. As an initial step towards starting this discourse, my thesis seeks to identify macroeconomic, policy-related, and institutional factors that have a role in attracting Chinese FDI to EU member states. It is crucial for member states to have an in-depth understanding of what host country characteristics and policies influence the investment decisions of Chinese multinational enterprises (MNEs) for three key reasons. First, understanding the nature of Chinese investments, ultimately, takes us a step closer to being able to address anxieties about them with efficient policies. Second, it allows host countries to target investments in unwanted sectors with effective restriction measures. Third, understanding these investments could also enable member states to attract more FDI, directed to preferential sectors, if they wanted to.

The EU is a particularly interesting case to investigate, as Chinese investments have been dominating the European policy and security discourse in recent years and the FDI screening framework is going into effect in October 2020. Moreover, there is no harmonised EU policy on FDI, thus member states all have their own specialised screening mechanisms or no mechanisms at all.[10] Based on the current escalation of events, Chinese FDI in Europe will stay a much-discussed topic in the upcoming years making it an important topic to research.

In order to explore Chinese investments in the EU, I analyse data from the American Enterprises Institute's China Global Investment Tracker from 2003 to 2018. I employ panel data analysis to identify host country characteristics that influence Chinese MNEs' location choices about FDI. I set my hypotheses based on existing FDI literature and theory. Results show that the number of patent applications has a significant positive

[10] Schüler-Zhou, Yun, Margot Schüller, and Magnus Brod. 'Push and Pull Factors for Chinese OFDI in Europe'. In *Chinese International Investments*, edited by Ilan Alon, Marc Fetscherin, and Philippe Gugler, 157–74. London: Palgrave Macmillan UK, 2012.

impact on Chinese FDI inflows, while FDI restrictions have a significant negative impact. Market growth, political stability, corruption control, and trade relations with China are statistically insignificant.

The thesis is structured as follows. First, I provide a literature review on general FDI theory and its potential applications for the case of Chinese FDI. Then I discuss the characteristics of Chinese investments in Europe and the sources of anxiety in the Bloc. This should provide the necessary context to understand both sides of the investments, and to gain a clear view of what makes Chinese FDI different. To further expand on this argument, I review FDI theory and highlight how Chinese FDI is different from other countries' investments. Following this, I develop and test hypotheses formulated based on existing FDI literature and theory to gain a better understanding of the locational aspects of Chinese investments in Europe. Finally, I present and discuss my results in light of the existing literature and current international politics.

1. Literature review

1.1. FDI theory

A core FDI theory dominating the literature is John H. Dunning's eclectic paradigm, also known as ownership, location, internalisation (OLI) paradigm, which was initially put forward in 1977,[11] then later refined in 1979[12] and again in 1993.[13] It 'seeks to offer a general framework for determining the extent and pattern of both foreign-owned production undertaken by a country's own enterprises, and that of domestic production owned or controlled by foreign enterprises.'[14] According to the paradigm, companies expand abroad when they have firm-specific ownership (O) and internalisation (I) advantages vis-à-vis the firms in the host market, and when it benefits from creating or accessing these foreign market locations (L).[15] For the purposes of this paper, I only intend to focus on the location element of the OLI model, as for the ownership and internalisation aspects, I would need information from the companies themselves.

Within the location element of foreign MNE investment activities, Dunning distinguishes between four motives: i) natural resource-seeking;

ii) market-seeking; iii) efficiency-seeking; and iv) strategic asset- or capability-seeking.[16] Natural resource seekers engage in cross-border investment to gain access to certain higher-quality resources at lower costs.[17] Whereas market-seeking means either MNEs sustaining and protecting their existing markets, or exploiting and promoting new

[11] Dunning, John H. 'Trade, Location of Economic Activity and the MNE: A Search for an Eclectic Approach'. In *The International Allocation of Economic Activity: Proceedings of a Nobel Symposium Held at Stockholm*, edited by Bertil Ohlin, Per-Ove Hesselborn, and Per Magnus Wijkman, 395–418. London: Palgrave Macmillan UK, 1977.
[12] Dunning, John H. 'Explaining Changing Patterns of International Production: In Defence of the Eclectic Theory'. *Oxford Bulletin of Economics and Statistics* 41, no. 4 (1979): 269–95.
[13] Dunning, Professor John H. *The Globalization of Business*. London: Cengage Learning EMEA, 1993.
[14] Dunning, John H., and Sarianna M. Lundan. *Multinational Enterprises and the Global Economy*. Cheltenham, UK; Northampton, MA: Edward Elgar Publishing, 2008. 95.
[15] Ibid, 99-100.
[16] Ibid, 67-68.
[17] Ibid, 69.

ones.[18] In general, efficiency-seeking is about MNEs' exploiting of 'different factor endowments, cultures, institutional arrangements, demand patterns, economic policies and market structures.'[19] While a strategic asset-seeking MNE's goal is 'to capitalise on the benefits of the common ownership of diversified activities and capabilities.'[20] The location aspect of the OLI paradigm serves as a good starting point for FDI research, but it is important to note that it has limitations, as the framework was created with FDI flows from developed to emerging and developing countries in mind. Hence, for example, it is difficult to speak about efficiency or natural resource seeking in case of Chinese FDI in the EU, because factor endowments and natural resources are unlikely to be cheaper in the Bloc than in China.

For a framework that is not rooted in economic efficiency-seeking, we can turn to the institutional approach. Drawing on institutional theory,[21] Tatiana Kostova and Srilata Zaheer created an institutional framework for MNEs.[22] They contend that three factors influence an MNE's legitimacy in the host country: institutional environment, the organisation, and the process of legitimisation. First, within the institutional environment, the authors distinguish regulatory, cognitive, and normative complexities that an MNE can face in domains that affect their legitimacy. For every country an MNE is present in, it has to navigate a different institutional environment, and similarly, there are also differences between the institutions in the home, and in host countries. Second, the organisation factor captures MNEs being stuck between two distinct environments: their parent company and host country. Third, the process of legitimation represents the host

[18] Ibid, 70.
[19] Ibid, 72.
[20] Ibid, 73.
[21] Meyer, John W., and Brian Rowan. 'Institutionalized Organizations: Formal Structure as Myth and Ceremony'. *American Journal of Sociology* 83, no. 2 (1977): 340–63; Zucker, Lynne G. 'Organizations as Institutions'. *Research in the Sociology of Organizations* 2, no. 1 (1983): 1–47.
[22] Kostova, Tatiana, and Srilata Zaheer. 'Organizational Legitimacy under Conditions of Complexity: The Case of the Multinational Enterprise'. *The Academy of Management Review* 24, no. 1 (1999): 64–81.

country's perception and attitude towards foreign MNEs and spillovers from other cognitively related units.[23]

While combining the OLI and institutional approaches is a good way to approach investigating Chinese FDI, Peter J. Buckley et al. raise the legitimate question of whether we need a special FDI theory to analyse these investment flows.[24] The authors bring forward three arguments as to why the current theories are not necessarily applicable to Chinese FDI, and why a new theory could be required. One of the main reasons are capital market imperfections that are common in developing countries, including China. The authors mention imperfections such as SOEs having access to below-market-rate capital; banks making soft loans to these companies; inefficient capital markets at home might subsidise outward investment; or loans from the wider family being available to family-owned firms.[25] Another reason is that developing country MNEs have ownership advantages that could make them more efficient than local firms in the host country. The authors mention, for example, the advantages these firms might have in emerging economies, having a developing home economy themselves. Specifically, an advantage Chinese firms could exploit is the extensive diasporas abroad allowing for more efficient network building.[26] And finally, the institutional fabric of an economy has implications for a company's ability to succeed in investing abroad. This is no different in the case of China, where the state has a profound influence on Chinese MNEs internationalisation decisions, and where every outbound FDI project has to be approved by the state administration.[27]

[23] Ibid, 68.
[24] Buckley, Peter J., L. Jeremy Clegg, Adam Cross, Xin Liu, Hinrich Voss, and Ping Zheng. 'The Determinants of Chinese Outward Foreign Direct Investment'. In *Foreign Direct Investment, China and the World Economy*, edited by Peter J. Buckley, 81–118. London: Palgrave Macmillan UK, 2010.
[25] Ibid, 85.
[26] Ibid, 86.
[27] Ibid, 88.

Even without a specific theory to apply to them, there have been numerous endeavours to address and analyse Chinese FDI outflows,[28] and authors tackled the specific case of Europe as well.[29] Chinese companies started increasing their FDI at an accelerated speed in the 2000s, and the EU has been one of the targets of this upsurge. From the Chinese companies' point of view, there were two main reasons for their interest in the EU: market-seeking Chinese companies wanted access to the common market, while asset-seeking enterprises were attracted by the high level of industrialisation in Europe.[30] Chinese investment was particularly welcome in the EU after the global financial crisis of 2008. During this period, European investment promotion agencies were seeking to attract FDI from all over the world, including emerging economies.[31] Thus, the shift from encouraging investments to fearing and screening them was relatively fast. In 2002, Kay Möller noted that 'the EU's China policies often appear as being driven

[28] Liu, Xiaohui, Trevor Buck, and Chang Shu. 'Chinese Economic Development, the next Stage: Outward FDI?' *International Business Review* 14, no. 1 (1 February 2005): 97–115; Buckley, Peter J., L. Jeremy Clegg, Adam R. Cross, Xin Liu, Hinrich Voss, and Ping Zheng. 'The Determinants of Chinese Outward Foreign Direct Investment'. *Journal of International Business Studies* 38, no. 4 (2007): 499–518; Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2010; Morck, Randall, Bernard Yeung, and Minyuan Zhao. 'Perspectives on China's Outward Foreign Direct Investment'. *Journal of International Business Studies* 39, no. 3 (1 April 2008): 337–50; Alon, Titan M. 'Institutional Analysis and the Determinants of Chinese Outward FDI'. *Multinational Business Review*, Vol. 18 No. 3 (2010), pp. 1-24; Voss, Hinrich. *The Determinants of Chinese Outward Direct Investment*. Cheltenham, UK: Edward Elgar Publishing, 2011.

[29] Dreger, Christian, Yun Schüler-Zhou, and Margot Schüller. 'Determinants of Chinese Direct Investments in the European Union'. *Applied Economics* 49, no. 42 (8 September 2017): 4231–40; Manzoor, Amir. 'Chinese FDI Activity in Europe: Trends, Impacts, and Challenges'. *Handbook of Research on Economic, Financial, and Industrial Impacts on Infrastructure Development*, 2017, 285–301; Matura, Tamás. 'Chinese Investment in the EU and Central and Eastern Europe'. *China's Attraction: The Case of Central Europe*, 2017, 49–72; Szunomár, Ágnes, and Zsuzsánna Biedermann. Chinese Outward FDI in Europe and the Central and Eastern European Region within a Global Context. Budapest: Hungarian Academy of Sciences Centre for Economic and Regional Studies Institute of World Economics, 2014, accessed 18 May 2020, http://real.mtak.hu/13578/1/Szunomár-Biedermann_WP_207.pdf; Zhang, Haiyan, and Daniel Van Den Bulcke. 'China's Direct Investment in the European Union: A New Regulatory Challenge?' *Asia Europe Journal* 12, no. 1 (1 March 2014): 159–77.

[30] Hanemann, Thilo, Mikko Huotari, and Agatha Kratz. 'Chinese FDI in Europe: 2018 Trends and Impact of New Screening Policies'. Mercator Institute for China Studies (MERICS), March 2019, accessed 23 March 2019, https://www.merics.org/sites/default/files/2019-03/190311_MERICS-Rhodium%20Group_COFDI-Update_2019.pdf.

[31] Meunier, Sophie. '"Beggars Can't Be Choosers": The European Crisis and Chinese Direct Investment in the European Union'. *Journal of European Integration* 36, no. 3 (16 April 2014): 283–302.

by events (including the Union's own institutional evolution) rather than driving events.'[32] This is just as true today as it was at the turn of the millennia. We have seen this with the case of Chinese investments in the EU as well. By the time the EU started to tackle these investments with direct policies, Chinese FDI stock actually started declining and Chinese capital was already present in strategic sectors.

1.2. What is it about Chinese investments in the EU?

MNEs causing political friction through FDI in both their home and host countries is a common phenomenon. Worries about national interests, labour market, environmental, and tax impacts all play into these concerns.[33] As Raymond Vernon phrases it '[l]arge enterprises cannot avoid making waves.'[34] The author puts forward an in-depth analysis of the struggle between nation-states and MNEs and explains:

> The regime of nation-states is built fundamentally on the principle that the people in any national jurisdiction have a right to try to maximize their well-being, as they define it, within that jurisdiction. The multinational enterprise, on the other hand, is bent on maximizing the well-being of its stakeholders from global operations, without accepting any direct responsibility for the consequences of its actions in individual national jurisdictions.[35]

Yet, Chinese outbound FDI is special in the sense that it triggers anxieties in a way no other investments seem to do. Exacerbated fears of Chinese investments were among the main reasons why in 2015, the European Commission put forward its plans for a more sustainable, transparent, and responsible investment strategy, emphasising the importance of rebalancing the EU's relationship with China in a way that is beneficial for both

[32] Möller, Kay. 'Diplomatic Relations and Mutual Strategic Perceptions: China and the European Union'. *The China Quarterly*, no. 169 (2002): 10–32. 31.
[33] Vernon, Raymond. *In the Hurricane's Eye: The Troubled Prospects of Multinational Enterprises*. Cambridge, MA: Harvard University Press, 2009. 30.
[34] Ibid, 30.
[35] Ibid, 28.

parties.[36] A 2017 communication by the Commission further reiterated these objectives and acknowledged growing fears about foreign state-owned enterprises (SOEs) acquiring European companies with key technologies and of strategic importance. [37] The communication does not specifically mention China, but based on the preceding discourse and concerns about growing Chinese FDI in the Bloc, especially in strategic sectors, the Commission is ostensibly referring to China.[38]

The EU also endeavoured to take a harder foreign policy stance on China. In March 2019, the Commission published an infamous strategic outlook on China in which it declared the country a 'systemic rival.'[39] The document's action plan underscored the need for an FDI screening framework. The Commission initiated setting up a regulative framework for FDI screening in 2017; the completed framework was put forward in 2019 and would go into effect in 2020. The initiative takes into consideration that foreign investment inflows are closely tied to member states' exclusive responsibility for national security, hence it only outlines a set of minimum requirements and allows great flexibility for member states to adopt a screening process that fits them best. In accordance with this, implementing screening processes is not mandatory.[40]

In the following section, while building on the work of Sophie Meunier, I introduce four important reasons for why Chinese investments are raising concerns in the EU.

[36] European Commission. 'Trade for All - Towards a More Responsible Trade and Investment Policy', 15 October 2015, accessed 29 November 2019, https://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf.
[37] European Commission. 'Reflection Paper on Harnessing Globalisation', 10 May 2017, accessed 29 November 2019, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-globalisation_en.pdf.
[38] Grieger, Gisela. 'Foreign Direct Investment Screening: A Debate in Light of China-EU FDI Flows'. European Parliamentary Research Service (EPRS), May 2017, accessed 13 December 2019, http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/603941/EPRS_BRI(2017)603941_EN.pdf.
[39] European Commission, 'EU-China – A Strategic Outlook'. 1.
[40] European Parliament. 'Screening of Foreign Direct Investment in Strategic Sectors', 20 July 2019, accessed 23 August 2019, http://www.europarl.europa.eu/legislative-train.

1.2.1. Novelty

First, Chinese investments are still a novelty.[41] Meunier argues that at the turn of the century China was not a major global player in FDI and there is a general perception that ‘a new source of investment’ is ’something to be feared.’[42] To support her theory Meunier uses historical examples of foreign investment flows to Europe from the United States (1960s) and Japan (1980s) that triggered similar fears as Chinese FDI does currently. She argues that once the novelty wears off, the general public will not perceive these investments as threatening.[43] Another factor that adds to the novelty, is that it is still generally perceived unusual for developing countries to invest in developed countries.[44] Meunier explains ‘the influx of direct investment from a developing to a developed economy, which has no historical precedent, shakes the traditional political dynamics of FDI and poses somewhat of an existential problem for the host countries.’ She argues that Chinese investments are interpreted as a sign of a rising China and shifting power dynamics.[45]

The surge in FDI from developing economies has been remarkable. While in the mid-1990s FDI flows from these countries only made up four per cent of all global FDI flows, by 2015 they accounted for one-fifth.[46] There have been numerous attempts in the literature to explain FDI originating from developing economies.[47] In his 2008 article,

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[41] Meunier, Sophie. ‘Beware of Chinese Bearing Gifts: Why China’s Direct Investment Poses Political Challenges in Europe and the United States’. In *China’s Three-Prong Investment Strategy: Bilateral, Regional, and Global Tracks*, edited by Julien Chaisse. Oxford University Press, 2019.
[42] Ibid, 2.
[43] Ibid.
[44] Meunier, ‘“Beggars Can’t Be Choosers”’.
[45] Meunier, ‘Beware of Chinese Bearing Gifts’.
[46] Jose Ramon Perea Matthew Stephenson. ‘Outward FDI from Developing Countries’. In *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications*, 101–34. The World Bank, 2017. 101.
[47] Dunning, Narula, and Hoesel, ‘Explaining the “new” Wave of Outward FDI from Developing Countries’; Lecraw, Donald J. ‘Direct Investment by Firms from Less Developed Countries’. *Oxford Economic Papers* 29, no. 3 (1977): 442–57; Mathews, John A. ‘Dragon Multinationals: New Players in 21st Century Globalization’. *Asia Pacific Journal of Management* 23, no. 1 (1 March 2006): 5–27.; UNCTAD. ‘World Investment Report 2006’. New York: United Nations, 2006, accessed 15 July 2019, https://unctad.org/en/docs/wir2006_en.pdf.

Peter Gammeltoft distinguishes three waves of FDI flows from developing economies.[48] The first wave happened between the 1960s and mid-1980s. These FDI flows could be characterised as mainly market- and efficiency-seeking. They targeted other emerging economies, mainly neighbouring countries. Source countries predominantly included Latin American countries.[49] During the second wave, lasting from the mid-1980s until the 1990s, developing country FDI was mostly about strategic-asset seeking. This was when FDI flows started targeting advanced economies. There was also a geographical shift in the source countries from Latin America to Asia.[50] The third wave happened between the 1990s and 2000s and can be described with the re-emergence of Latin American source countries, more diverse target countries and sectors, and an increased focus on advanced economies.[51] It could be argued that Chinese investments skyrocketing in the 2013s (from the announcement of the BRI) marks the fourth wave of FDI flows from developing to advanced economies.

1.2.2. Mergers and acquisitions

MNEs' market entry strategies have been gathering attention in the literature, particularly their use of mergers and acquisitions (M&As). In case of a merger, two existing companies unite to create a new one; and with acquisitions, one company buys another. M&As are often seen as a shortcut to seek strategic assets.[52] This is grounded in the trend that developing and emerging market MNEs predominantly choose acquisitions

[48] Gammeltoft, Peter. 'Emerging Multinationals: Outward FDI from the BRICS Countries'. *International Journal of Technology and Globalisation* 4, no. 1 (September 2008): 5–22. 9.
[49] Ibid.
[50] Ibid.
[51] Ibid.
[52] Anderson, John, and Dylan Sutherland. 'Entry Mode and Emerging Market MNEs: An Analysis of Chinese Greenfield and Acquisition FDI in the United States'. *Research in International Business and Finance* 35 (1 September 2015): 88–103; Kedia, Ben, Nolan Gaffney, and Jack Clampit. 'EMNEs and Knowledge-Seeking FDI'. *Management International Review* 52, no. 2 (1 April 2012): 155–73; Sun, Sunny Li, Mike W. Peng, Bing Ren, and Daying Yan. 'A Comparative Ownership Advantage Framework for Cross-Border M&As: The Rise of Chinese and Indian MNEs'. *Journal of World Business*, Focus on China Special Section, 47, no. 1 (1 January 2012): 4–16.

over greenfield investments as an entry mode to developed markets.[53] Chinese investments are not different either. In the past years, the split between acquisitions and greenfield investments in Chinese FDI in Europe has been steadily 95 to 5 per cent.[54] Greenfield investments are new investments, thus policymakers and the public tend to perceive them in a more positive light.[55] As Meunier puts it, greenfield investment is considered 'more innocuous and less politically problematic.'[56] It is 'seen to enlarge directly existing supply capacity, create new jobs and increase competition in the market.'[57] But Marina Wes and Hans Peter Lankes underscore that acquisitions have benefits for the host country as well. For example, M&As create assets as well, albeit indirectly through capital expansion. They can also lead to technology spillovers. In addition, M&As tend to encourage the utilisation of local suppliers instead of importing supplies, as is the case with greenfield investments.[58] However, Agatha Kratz et al. warn that the trend of Chinese MNEs preferring M&As as a mode of entry might shift as pursuing acquisitions is becoming more difficult in the EU, and Chinese companies turn towards other ways to enter the market.[59] While this sets out interesting questions about how perceptions of Chinese investments in Europe might change, it is still unlikely that the EU will see them more favourably.

[53] Anderson and Sutherland, 'Entry Mode and Emerging Market MNEs'.
[54] Kratz et al., 'Chinese FDI in Europe: 2019 Update'. 9.
[55] OECD. *International Investment Perspectives: Freedom of Investment in a Changing World.* OECD Publishing, 2007, accessed 29 December 2019, https://www.oecd.org/investment/investment-policy/39447653.pdf. 68.
[56] Meunier, 'Beware of Chinese Bearing Gifts'. 3.
[57] Wes, Marina, and Hans Peter Lankes. 'FDI in Economies in Transition: M&As versus Greenfield Investment'. *Transnational Corporations* 10, no. 3 (2001): 113–129. 127.
[58] Ibid.
[59] Kratz et al., 'Chinese FDI in Europe: 2019 Update'.

1.2.3. Chinese political influence

Understanding the determinants of Chinese FDI is a complex task, as they are inextricably intertwined with the interests of the Chinese government. Fears about these investments are worsened by the potential influence that the Chinese government exerts through them.

First, Chinese investment projects are often part of the Belt and Road Initiative (BRI). The BRI, launched in 2013, is a project officially aiming to improve connectivity and foster international cooperation. It is open to any country that would like to participate in it. While there is no official list of participants, there are 71 countries that are 'geographically located along BRI transport corridors.'[60] The BRI actually pulled together several ongoing projects under one name. A report by the World Bank's Cristina Constantinescu and Michele Ruta analysed Chinese trade patterns and found that 'the BRI announcement in 2013 put a stamp on a complex and, by then, already ongoing process.'[61] The authors also contend that 'the BRI announcement was not a dramatic shift, but it brought new energy and focus to ongoing trends in China's trade relations.' While it is hard to make accurate estimations about the size of overall BRI investments, as there is no generally agreed definition of what constitutes a BRI project, there are rough estimates available. According to recent data, China invested over 70 billion USD into infrastructure projects under the BRI's umbrella by 2018, not including the aforementioned ongoing projects.[62]

[60] World Bank. 'Belt and Road Initiative'. World Bank, 29 March 2018, accessed 13 May 2020, https://www.worldbank.org/en/topic/regional-integration/brief/belt-and-road-initiative.
[61] Constantinescu, Cristina, and Michele Ruta. 'How Old Is the Belt and Road Initiative?' Washington D.C.: World Bank Group, MTI Practice Note, December 2018, accessed July 22, 2019, http://documents.worldbank.org/curated/en/984921545241288569/How-Old-is-the-Belt-and-Road-Initiative-Long-Term-Patterns-of-Chinese-Exports-to-BRI-Economies.' 60.
[62] Eder, Thomas S. 'Mapping the Belt and Road Initiative: This Is Where We Stand'. Mercator Institute for China Studies (MERICS), 7 June 2018, accessed 23 August 2019, https://www.merics.org/en/bri-tracker/mapping-the-belt-and-road-initiative.

The BRI was primarily born out of China's need to sustain economic growth, but it quickly became Xi Jinping's flagship foreign policy project after he became president in 2013. Due to its heavily politicised nature, it has been a controversial initiative, with accusations of debt diplomacy, corruption, and negative environmental and social impacts.[63] A recent publication by the European Union Chamber of Commerce in China captures this controversial nature well by contending that '[s]ome observers have compared it to the Marshall Plan while others interpret it as a strategy for creating vassal states through debt-trap diplomacy.'[64]

Second, many Chinese MNEs are state-owned enterprises. SOE's are 'firms that are at least 20 percent owned and controlled by the government or a central state-owned enterprise.'[65] This raises concerns about the influence the Chinese government might have over these companies and their investment decisions. A briefing paper by Gisela Grieger from the European Parliament's Members' Research Service from 2017 specifically states as a China-specific concern related to Chinese FDI that 'Chinese political economy, where state interference prevails over market forces, and the lines between the public and the private sector are blurred.'[66]

One of the most salient advantages of MNEs is that they allow for easier and more flexible resource transfer than uni-national companies.[67] However, Chinese MNEs are distinct in the sense that a significant chunk of them, roughly 27 per cent, are SOEs. And overall, 41 per cent of Chinese firms engaging in foreign acquisitions are SOEs.[68]

[63] World Bank, 'Belt and Road Initiative'.
[64] European Union Chamber of Commerce in China. 'The Road Less Travelled: European Involvement in China's Belt and Road Initiative', 16 January 2020, 13 May 2020, https://static.europeanchamber.com.cn/upload/documents/documents/The_Road_Less_Travelled[762].pdf . 2.
[65] Kratz et al., 'Chinese FDI in Europe: 2019 Update'. 12.
[66] Grieger, 'Foreign Direct Investment Screening'.
[67] Kogut, Bruce. 'Foreign Direct Investment as a Sequential Process'. *The Multinational Corporation in the 1980s*, 1983, 38–56.
[68] Clougherty, Joseph A., and Wenxin Guo. 'The Effectiveness of the State in Chinese Outward Foreign Direct Investment: The "Go Global" Policy and State-Owned Enterprises'. In *Emerging Economies and*

Between 2010 and 2015 investments by SOEs made up for 70 per cent of total Chinese investment in Europe.[69] SOEs are key drivers of Chinese FDI globally as well as in Europe: investments from SOEs represented 60 per cent of all investment in Europe since 2000. In 2017, shares of SOEs accounted for over half of all Chinese investments.[70] But they started slackening in 2018 and by 2019 they only made up 11 per cent of all investments.[71] Nevertheless, whether an investment is coming from a company that is owned by the state or not has an impact on the perception of these inflows.

In 2019, the European Commission published a comprehensive report on FDI in Europe, using a firm-based database to provide a more reliable source for FDI data.[72] The report concluded that only three per cent of individual European companies were owned by foreign investors in 2016, but that 3 per cent made up 35 per cent of all assets in the sample. While advanced economies still own 80 per cent of the EU's foreign-owned assets, there has been a surge of investment from emerging economies, particularly from China.[73] The report specifically emphasises the growing number of acquisitions made by SOEs, referring to China.

Third, Chinese companies tend to target strategically important sectors which often raises concerns of espionage and intellectual property theft in the host countries.[74] As we have seen in the latest data, this is not different in Europe either, with Chinese investments targeting sectors such as automotive, ITC, and financial services.[75] And for a reason: one

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Multinational Enterprises, 28:141–59. Advances in International Management 28. Emerald Group Publishing Limited, 2015.

[69] Kratz et al., 'Chinese FDI in Europe: 2019 Update'. 12.

[70] European Commission. 'Commission Staff Working Document on Foreign Direct Investment in the EU'. European Commission, 13 March 2019, accessed 19 July 2019, http://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf. 60.

[71] Kratz et al., 'Chinese FDI in Europe: 2019 Update'. 12.

[72] European Commission, 'Commission Staff Working Document on Foreign Direct Investment in the EU'.

[73] Ibid, 1.

[74] Meunier, 'Beware of Chinese Bearing Gifts'.

[75] Kratz et al., 'Chinese FDI in Europe: 2019 Update'.

of the most beneficial advantages of FDI for the company is the spillover of know-how and new technologies.[76] But in the case of ITC, a new and very specific concern surfaces, intellectual property theft and espionage. The previously quoted briefing paper by the European Parliament states ‘China has a record of poor oversight of its export control rules, of political and economic espionage, and of insufficient protection of intellectual property rights.’[77] As we have seen with the disputes whether high-risk vendors should be allowed to build the European 5G networks,[78] concerns about intellectual property theft and espionage are still driving forces when it comes to debates about Chinese investments in the EU.

1.2.4. Divide and rule

Chinese investments are perceived to divide the EU. The *divide et impera* or ‘divide and rule’ argument implies that Chinese investment could hinder European integration by exploiting frictions between member states.[79] An example of this strategy is pitting Western European members against Eastern European ones.[80] China has been courting Central and Eastern European (CEE) EU member states for years. Smaller states are easier to gain influence in: China can build political leverage in these states in exchange for investments and jobs.[81] There are anxieties about Chinese influence growing

[76] Rand, John. ‘Understanding FDI Spillover Mechanisms’. *Brookings*, 19 November 2015, accessed 13 May 2020, https://www.brookings.edu/blog/africa-in-focus/2015/11/19/understanding-fdi-spillover-mechanisms/.
[77] Grieger, ‘Foreign Direct Investment Screening’. 4.
[78] European Commission. ‘Cybersecurity of 5G Networks EU Toolbox of Risk Mitigating Measures’. Brussels: European Commission, 29 January 2020, accessed 9 May 2020, https://ec.europa.eu/newsroom/dae/document.cfm?doc_id=64468.
[79] Boyes, Roger. ‘China Wants to Divide and Rule in Europe’. *The Times*, 19 March 2019, accessed 7 December, 2019, https://www.thetimes.co.uk/article/china-wants-to-divide-and-rule-in-europe-9tsj8wvcf; Kuo, Lily. ‘“Divide and Conquer”: China Puts the Pressure on US Allies’. *The Guardian*, 2 February 2019, accessed 7 December 2019, https://www.theguardian.com/world/2019/feb/02/divide-and-conquer-china-puts-the-pressure-on-us-allies’.
[80] Meunier, Sophie. ‘Divide and Conquer: China and the Cacophony of Foreign Investment Rules in the EU’. *Journal of European Public Policy* 21, no. 7 (2014): 996–1016.
[81] Benner, Thorsten, Jan Gaspers, Mareike Ohlberg, Lucrezia Poggetti, and Kristin Shi-Kupfer. ‘Authoritarian Advance: Responding to China’s Growing Political Influence in Europe’, February 2018,

everywhere around Europe, but it has been framed as particularly worrying that China has gained a foothold in CEE.[82] This is most likely because China's involvement in the region is institutionalised by being part of major projects such as the 17+1 Cooperation and the BRI.

However, it is important to recognise that Chinese investments in Europe are still concentrated in Western and more recently Northern Europe rather than in CEE.[83] Looking exclusively at 2018, the UK was still the most favoured target country of Chinese investment, followed by Sweden, and Germany.[84] In 2019, the target locations of Chinese FDI shifted somewhat from Western Europe to Northern Europe. Finland was the largest recipient of Chinese FDI, followed by the UK and then Sweden.[85] It is also worth mentioning as a recent development that in March 2019, during Xi Jinping's state visit, Italy announced that they are to be the first G7 country to join the BRI.[86] This implies that CEE will most likely not be the EU's main concern soon as they have strategically more important member states to worry about.

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accesed 3 December 2019, https://www.gppi.net/media/Benner_MERICS_2018_Authoritarian_Advance.pdf.

[82] Karásková, Ivana, Tamás Matura, Richard Q. Turcsányi, and Matej Šimalčík. 'Central Europe for Sale: The Politics of China's Influence'. National Endowment for Democracy Policy Paper 3 (2018), accessed 18 May 2020, https://www.amo.cz/wp-content/uploads/2018/04/AMO_central-europe-for-sale-the-politics-of-chinese-influence.pdf'; Matura, Tamas. 'China–CEE Trade, Investment and Politics'. *Europe-Asia Studies* 71, no. 3 (16 March 2019): 388–407; Szunomár, Ágnes. 'Blowing from the East'. *International Issues & Slovak Foreign Policy Affairs* XXIV, no. 03 (2015): 60–77; Turcsányi, Richard. 'Central and Eastern Europe's courtship with China: Trojan horse within the EU?', January 2014, accessed 18 April 2019, http://www.eias.org/eu-asia-at-a-glance/central-and-eastern-europes-courtship-with-china-trojan-horse-within-the-eu-january-2014/; Warsaw Institute Foundation. 'China's Influence in Balkans and Central and Eastern Europe'.

[83] Hanemann, Huotari, and Kratz, 'Chinese FDI in Europe'. 12.

[84] Ibid, 10.

[85] Mardell, Jacob. 'Belgrade Briefings on Bossy Brussels and Benevolent Beijing'. *MERICS Blog - European Voices on China*, 20 May 2019, accessed 25 July 2019, https://www.merics.org/en/blog/belgrade-briefings-bossy-brussels-and-benevolent-beijing.

[86] Giuffrida, Angela. 'Italy and China in Plan for New Silk Road-Style Trade Network'. *The Guardian*, 23 March 2019, accessed 27 September 2019, https://www.theguardian.com/world/2019/mar/23/italy-china-new-silk-road-belt-and-road-g7.

In the following parts of the thesis, I develop hypotheses about the determinants of Chinese investments in the EU based on existing theory and literature, explain my data and methodology, and finally discuss my results and its wider implications for the EU and future policymaking.

2. Hypothesis development

Market-seeking

As we have seen it in the literature review, market-seeking is one of the main motives behind MNEs' locational choices for FDI, and this is not different in the case of Chinese MNEs either.[87] The importance of the market-seeking motive is mainly rooted in competitive pressure in the Chinese market as well as MNEs ambitions to branch out to new markets and create brand awareness.[88] John H. Dunning and Sarianna M. Lundan mention market growth as one of the most salient reasons for an MNE to engage in market-seeking activities.[89] It is one of the most commonly used indicators in research concerned with the locational determinants of FDI.[90] High growth potential in the host market implies higher returns to scale and tends to attract more FDI.[91] There is a vast amount of empirical evidence finding significant positive relation between the growth potential of a market and FDI.[92] Therefore, Chinese MNEs are expected to consider market growth when seeking to penetrate a foreign market:

H1: Chinese FDI is positively related to market growth in the host country.

[87] Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2010; Brennan, Louis. 'The Challenges for Chinese FDI in Europe', *Columbia FDI Perspectives* no. 142, 2015; Kang, Yuanfei, and Fuming Jiang. 'FDI Location Choice of Chinese Multinationals in East and Southeast Asia: Traditional Economic Factors and Institutional Perspective'. *Journal of World Business*, Focus on China Special Section, 47, no. 1 (1 January 2012): 45–53; Lu, Jiangyong, Xiaohui Liu, and Hongling Wang. 'Motives for Outward FDI of Chinese Private Firms: Firm Resources, Industry Dynamics, and Government Policies'. *Management and Organization Review* 7, no. 2 (2011): 223–48.
[88] Kang and Jiang, 'FDI Location Choice of Chinese Multinationals in East and Southeast Asia'.
[89] Dunning and Lundan, *Multinational Enterprises and the Global Economy*. 70.
[90] Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2007; Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2010; Mistura, Fernando, and Caroline Roulet. 'The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?' OECD Working Papers on International Investment, 2019, accessed 29 December 2019, https://www.oecd- https://www.oecd-ilibrary.org/docserver/641507ce-en.pdf?expires=1577646405&id=id&accname=guest&checksum=35CAA7ABECBB0BCC75B8398F1ACF8D36.
[91] Mistura and Roulet, 'The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?'
[92] Anderson and Sutherland, 'Entry Mode and Emerging Market MNEs'; Cheung, Yin-Wong, and Xingwang Qian. 'Empirics of China's Outward Direct Investment'. *Pacific Economic Review* 14, no. 3

Strategic asset-seeking

Strategic asset seeking is one of the most important aspects to analyse when it comes to Chinese FDI considering the growing fears of Chinese influence in the EU. Several authors argue and find that seeking strategic resources is one of the most salient motives of Chinese MNEs.[93] In the case of the EU, this would manifest as acquiring knowledge and know-how from mature European MNEs.[94] Therefore, host countries with more strategic assets are expected to be more attractive to Chinese MNEs.

H2: Chinese FDI is positively related to the host country's strategic assets.

Openness

A country's openness should affect how attractive it is to investors. An angle worth discussing in case of the EU is FDI barriers. There are many ways in which these barriers might manifest, some examples are foreign equity limitations, screening or approval mechanisms, employment or operational restrictions.[95] The openness of an economy is also commonly measured by the ratio of exports and imports to the GDP.[96] Therefore, I expect that countries openness to FDI and trade should have an impact on Chinese FDI.

H3: Chinese FDI is negatively related to the host country's FDI barrier.

H4: Chinese FDI is positively related to the host country's trade volume with China.

(2009): 312–41; Mistura and Roulet, 'The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?'; Schneider and Frey, 'Economic and Political Determinants of Foreign Direct Investment'.

[93] Deng, Ping. 'Investing for Strategic Resources and Its Rationale: The Case of Outward FDI from Chinese Companies'. *Business Horizons* 50, no. 1 (1 January 2007): 71–81; Deng, Ping. 'Why Do Chinese Firms Tend to Acquire Strategic Assets in International Expansion?' *Journal of World Business* 44, no. 1 (1 January 2009): 74–84.'; Morck, Randall, Bernard Yeung, and Minyuan Zhao. 'Perspectives on China's Outward Foreign Direct Investment'. *Journal of International Business Studies* 39, no. 3 (1 April 2008): 337–50; Ramasamy, Bala, Matthew Yeung, and Sylvie Laforet. 'China's Outward Foreign Direct Investment: Location Choice and Firm Ownership'. *Journal of World Business*, Focus on China Special Section, 47, no. 1 (1 January 2012): 17–25; Rui, Huaichuan, and George S. Yip. 'Foreign Acquisitions by Chinese Firms: A Strategic Intent Perspective'. *Journal of World Business* 43, no. 2 (1 March 2008): 213–26.

[94] Kang and Jiang, 'FDI Location Choice of Chinese Multinationals in East and Southeast Asia'.

[95] Mistura and Roulet, 'The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?' 10.

[96] Chakrabarti, Avik. 'The Determinants of Foreign Direct Investments: Sensitivity Analyses of Cross-Country Regressions'. *Kyklos* 54, no. 1 (2001): 89–114.

Institutions

In the late 1990s, a new approach emerged in the literature attempting to explain economic development and FDI determinants with institutional factors, such as corruption, political instability, institutional quality, and economic incentives.[97] Good governance is normally associated with economic growth and attracting more FDI, whereas poor institutions might lead to corruption and a decrease in investment. But institutional factors are hard to measure and the literature has vague empiric results thus far.[98] For instance, many studies use the Polity Score, but as of 2018, there is little variation in the score for EU countries which all rank quite high on it, between 8 and 10 out of 10.[99] The case of EU countries is particularly difficult to analyse as it is hard to find a measure that captures the nuances of differences in institutional development between member states.

The first important indicator of the good quality of institutions in a country is political stability. Political stability and the lack of political instability is crucial to promote FDI inflows.[100] Imad A. Moosa and Buly A. Cardak have suggested before that improving a country's political and legal infrastructure is a good way for countries to attract FDI.[101] In addition, political regimes that mange to decrease political risks can attract more MNEs and FDI by lowering internalisation costs, and previous literature notes that democratic political institutions attract more FDI than authoritarian ones.[102]

[97] Assunção, Susana, Rosa Forte, and Aurora Teixeira. 'Location Determinants of FDI: A Literature Review', FEP Working Papers 433, Universidade do Porto, Faculdade de Economia do Porto.
[98] Walsh, James, and Jiangyan Yu. 'Determinants of Foreign Direct Investment: A Sectoral and Institutional Approach'. *IMF Working Papers* 10 (1 July 2010).
[99] Center for Systemic Peace. 'Polity5 Annual Time-Series, 1946-2018', 2018, accessed 17 May 2020, http://www.systemicpeace.org/inscr/p5v2018.xls, 5.
[100] Dutta, Nabamita, and Sanjukta Roy. 'Foreign Direct Investment, Financial Development and Political Risks' *The Journal of Developing Areas* 44, no. 2 (2011): 303–27; Gani, Azmat. 'Governance and Foreign Direct Investment Links: Evidence from Panel Data Estimations'. *Applied Economics Letters* 14, no. 10 (1 August 2007): 753–56.
[101] Moosa, Imad A., and Buly A. Cardak. 'The Determinants of Foreign Direct Investment: An Extreme Bounds Analysis'. *Journal of Multinational Financial Management* 16, no. 2 (1 April 2006): 199–211.
[102] Jensen, Nathan M. 'Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment'. *International Organization* 57, no. 3 (ed 2003): 587–616.

The second element that has received a lot of attention in recent years is corruption. Corruption is often viewed as a tax or the cost of doing business in the host country.[103] Several authors find that corruption in the host country has a negative impact on FDI.[104] For example, Adiya Belgibayeva and Alexander Plekhanov show that investment flows tend to be greater between countries with better corruption controls.[105] Whereas Heba E. Helmy finds that there is no connection between corruption and FDI.[106] Ram Mudambi et al. find that corruption has no independent influence on FDI but underscores that the host country's economic regulation (which corruption control is a part of) does affect investments.[107] This is in line with the assertion of Jingtao Yi et al. who find that the effect of corruption is dependent on which investment phase the MNE is in and its willingness to meddle in bribery.[108] Therefore, I expect that a country's political stability and corruption controls should affect Chinese FDI inflows.

H5: Chinese FDI is positively related to the political stability in the host country.

H6: Chinese FDI is positively related to corruption controls in the host country.

[103] Al-Sadig, Ali. 'The Effects of Corruption on FDI Inflows'. *Cato Journal* 29, no. 2 (2009): 267–94.
[104] Asiedu, Elizabeth. 'Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability'. *The World Economy* 29, no. 1 (1 January 2006): 63–77; Castro, Conceição, and Pedro Nunes. 'Does Corruption Inhibit Foreign Direct Investment?' *Política. Revista de Ciencia Política* 51, no. 1 (7 August 2013): 61–83; Mohamed, Sufian, and Moise Sidiropoulos. 'Another Look at the Determinants of Foreign Direct Investment in MENA Countries: An Empirical Investigation'. *Journal of Economic Development* 35 (1 June 2010): 75–95.
[105] Belgibayeva, Adiya, and Alexander Plekhanov. 'Does Corruption Matter for Sources of Foreign Direct Investment?' *Review of World Economics* 155, no. 3 (1 August 2019): 487–510.'
[106] Helmy, Heba E. 'The Impact of Corruption on FDI: Is MENA an Exception?' *International Review of Applied Economics* 27, no. 4 (1 July 2013): 491–514.
[107] Mudambi, Ram, Pietro Navarra, and Andrew Delios. 'Government Regulation, Corruption, and FDI'. *Asia Pacific Journal of Management* 30, no. 2 (1 June 2013): 487–511.
[108] Yi, Jingtao, Shuang Meng, Craig D. Macaulay, and Mike W. Peng. 'Corruption and Foreign Direct Investment Phases: The Moderating Role of Institutions'. *Journal of International Business Policy* 2, no. 2 (1 June 2019): 167–81.

3. Data and methods

3.1. Dependent variable

For analysing the FDI inflows into the EU (ln*IFDI*), this thesis uses data from the American Enterprise Institute's (AEI's) China Global Investment Tracker.[109] I chose the AEI's database over the comparable OECD and UNCTAD databases because it is the most comprehensive dataset available for open use. The AEI captures FDI flows around the world in US Dollars since 2005. I take the natural logarithm of the variable to correct the skewed distribution of the residuals and make the interpretation of the coefficients easier.

3.2. Independent variables

Market-seeking: GDP growth is used commonly as a proxy for market-seeking motivations, and I decided to use it as well. The variable *GDPG* captures GDP growth in the model. Data for the variable were extracted from the World Bank's database.[110]

Strategic asset-seeking: A previously used proxy for strategic assets in the host country is the number of patent applications in the given country,[111] and I use this variable as well as under the name *lnPATENT*, capturing the number of patent applications submitted by residents annually. Data was extracted from the World Bank's database.[112] As some of the *lnPATENT* variable's values are very small, I take the natural logarithm of the variable to make interpretation easier.

[109] American Enterprise Institute (AEI). 'China Global Investment Tracker', 2019, accessed 28 December 2019, https://www.aei.org/china-global-investment-tracker/.
[110] World Bank. 'GDP Growth (Annual %)'. World Bank, 2019, accessed 30 December 2019, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG.
[111] Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2007; Dreger, Schüler-Zhou, and Schüller, 'Determinants of Chinese Direct Investments in the European Union'; Kang and Jiang, 'FDI Location Choice of Chinese Multinationals in East and Southeast Asia'.
[112] World Bank. 'Patent Applications, Residents', 2019, accessed 30 December 2019, https://data.worldbank.org/indicator/IP.PAT.RESD.

Openness to FDI: To assess the openness of the host economies to FDI, I introduce FDI restriction (*FDIRE*). The variable uses data extracted from the OECD's FDI Regulatory Restrictiveness Index, which measures statutory restrictions on FDI in four dimensions: foreign equity limitations; ii) screening and approval mechanisms; iii) restrictions on foreign employees; iv) operational restrictions.[113] The index evaluates each country on a scale from 0 to 1, where 0 means open and 1 means closed to FDI. The overall FDI score is the average of the four aforementioned dimensions. While the OECD index is not a full measure of the host country's investment environment but is still critical in assessing a country's openness to FDI.[114] I also included the variable *TRADE* representing the trade-to-GDP ratio of each country with China to capture bilateral economic relations between the parties. Trade-to-GDP ratio was calculated as the aggregate of exports and imports between the Member State and China divided by the Member State's GDP. Data was extracted from the World Bank's GDP[115] and World Integrated Trade Solution databases.[116]

Institutions: The challenges of using appropriate data when it comes to the assessment of a link between taxation and FDI are known in the literature, but as it is the least resource-intensive, and often relied upon in other studies, I have decided to use statutory corporate tax rates as my primary indicator. The variable *TAXR* represents corporate tax rates in the host country. I extracted data from the OECD's Statutory Corporate Income Tax Rates database. *POLS* represents the political stability in the host country. Data is from the World Bank's Worldwide Governance Indicators (WGI)

[113] Mistura and Roulet, 'The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?' 10.
[114] OECD. 'OECD FDI Regulatory Restrictiveness Index', 2019, accessed 30 December 2019, https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#.
[115] World Bank. 'GDP (Current US$)'. World Bank, 2019, accessed 30 December 2019, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD'.
[116] World Bank. 'World Integrated Trade Solution (WITS)'. World Integrated Trade Solution (WITS), 2019, accessed 30 December 2019, https://wits.worldbank.org/Default.aspx?lang=en.

database, where one of the estimates is the 'political stability and absence of violence/terrorism.' The World Bank defines political stability as 'the likelihood of political instability and/or politically-motivated violence.'[117] I also introduce a corruption control (*CORR*) variable, using another available dimension from the same WGI database, which is control of corruption. The World Bank defines corruption as 'the extent to which public power is exercised for private gain […] as well as "capture" of the state by elites and private interests.'[118] Both indicators estimate governance over corruption and political stability on a scale from -2.5 to 2.5, where -2.5 is weak performance (implying that the country has high levels of corruption or no rule of law) and 2.5 is strong performance (meaning corruption levels are low and there is political stability).[119]

3.3. Estimation method

I formulated the following regression model:

$$ln(IFDI_{it}) = \alpha_i + \beta_1 GDPG_{it} + \beta_2 ln(PATENT)_{it} + \beta_3 FDIRE_{it} + \beta_4 TAXR_{it} + \beta_5 POLS_{it} + \beta_6 CORR_{it} + u_{it}$$

where *i* denotes the country and *t* represents the time period. I collected data from 28 EU economies for the period 2005-2018.

I conducted a Hausman test, based on which of the differences in coefficients are not systematic, hence I selected the random-effects model as the model specification. To check if there is multicollinearity in the model, I calculated the variance inflation factor (VIF). Results show that VIF=3.97 and imply that there is no serious multicollinearity in the model.

[117] World Bank. 'Political Stability and Absence of Violence/Terrorism: Estimate', 2019 , accessed 30 December 2019, https://datacatalog.worldbank.org/political-stability-and-absence-violenceterrorism-estimate.
[118] World Bank. 'Control of Corruption: Estimate, 2019, accessed 30 December 2019, https://datacatalog.worldbank.org/control-corruption-estimate-0.
[119] Ibid.

Table 1 summarises my hypotheses, proxies, and the theoretical justification behind them. Table 2 presents the descriptive statistics for the independent variables. Table 3 presents the correlation matrix.

Table 1
Summary of hypotheses

Hypothesis	Proxy	Expected sign	Theory	Source
H1: Market growth	*GDPG*: Annual *GDP* growth	+	Market-seeking	World Bank[120]
H2: Strategic assets	*PATENT*: number of patent applications by residents	+	Strategic asset-seeking	World Bank[121]
H3: FDI barrier	*FDIRE*: statutory restrictions on FDI	–	Openness to FDI	OECD[122]
H4: Trade relations	*TRADE:* the sum of a host country's import from and export to China divided by host country GDP	+	Openness to FDI	World Bank[123]
H5: Political stability	*POLS*: Host country's political stability rating	+	Institutional factors	World Bank[124]
H6: Corruption controls	*CORR*: Host country's control on corruption rating	+	Institutional factors	World Bank[125]

[120] World Bank, 'GDP Growth (Annual %)'.
[121] World Bank, 'Patent Applications, Residents'.
[122] OECD, 'OECD FDI Regulatory Restrictiveness Index'.
[123] World Bank, 'World Integrated Trade Solution (WITS)'.
[124] World Bank, 'Political Stability and Absence of Violence/Terrorism: Estimate'.
[125] World Bank, 'Control of Corruption: Estimate'.

Table 2
Descriptive statistics for the independent variables

Chinese FDI *(lnIFDI)*	Obs	Mean	Std. Dev.	Min	Max
GDP growth (*GDPG*)	392	2.090	3.764	-14.814	25.163
Patent applications (*lnPATENT*)	366	6.539	2.093	0.693	10.804
FDI restrictiveness (*FDIRE*)	240	0.033	0.024	0.004	0.149
Political stability (*POLS*)	392	0.745	0.395	-0.474	1.596
Corruption control (*CORR*)	392	1.023	0.790	-0.267	2.470
Trade relations (*TRADE*)	364	0.0540	0.1267	0.0046	1.0535

Table 3
Correlation matrix for the independent variables

Chinese FDI (*lnIFDI*)	1	2	3	4	5	6
GDP growth (*GDPG*)	1.0000					
Patent applications (*lnPATENT*)	-0.2418	1.0000				
FDI restrictiveness (*FDIRE*)	0.0345	0.3118	1.0000			
Political stability (*POLS*)	0.2542	-0.1790	0.1058	1.0000		
Corruption control (*CORR*)	0.0423	0.2598	0.0862	0.5288	1.0000	
Trade relations (*TRADE*)	-0.3340	-0.0741	-0.0114	-0.4335	-0.3220	1.0000

4. Results

Table 4 presents three model specifications: ordinary least squares (OLS), fixed-effects (FE), and random-effects (RE). I included results from the OLS and FE models for reference, but in the following, I will only focus on the results of the random-effects model. I found that the number of patent applications and the level of FDI restrictions in the host country were significant at the one per cent level and correctly signed. A one-point increase in the host country's level of FDI restrictions was associated with a 1435.6 per cent decrease in annual Chinese inward FDI in the host country, ceteris paribus. A one per cent increase in annual patent applications in the host country was associated with a 0.48 per cent increase in annual inward Chinese FDI, ceteris paribus. This means that I accept hypotheses 2 and 3. Market growth, political stability, corruption control, and trade relations were statistically insignificant, therefore hypotheses 1, 4, 5, 6 were rejected.

Table 4
Model estimation

Chinese FDI (*lnIFDI*)	OLS	FE	RE
GDP growth (*GDPG*)	0.0296	0.0553	-0.0400
	(0.0415)	(0.0392)	(0.0388)
Patent applications (*lnPATENT*)	0.4685	0.8066	0.4765
	(0.0698)***	(0.3948)*	(0.1036)***
FDI restrictiveness (*FDIRE*)	-11.4947	-32.4840	-14.3562
	(3.6980)***	(12.6419)**	(5.5244) ***
Political stability (*POLS*)	-0.8669	-1.2291	-0.9814
	(0.3735)**	(0.9685)*	(0.8489)
Corruption control (*CORR*)	0.4464	-0.3051	0.4646
	(0.1687)***	(1.3298)	(0.3578)
Trade relations (*TRADE*)	0.4112	3.0360	1.1479
	(0.8726)	(0.6913)***	(1.1227)
Constant	2.2879	1.4975	2.3355
	(0.5833)	(2.8756)	(0.9654)
Observations	200	200	200
R-squared	0.3390	0.2190	0.3324
Number of countries		24	24
Hausman test	χ^2= 7.02		
	(p=0.3194)		

Robust standard errors are in parentheses.
* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

5. Discussion

The number of patent applications filed in a country is important because it is considered a proxy for innovation. The number of applications having a positive significant impact on FDI inflows supports the hypothesis that Chinese investments target countries with know-how. My results are in line with the findings of Katarina Blomkvist and Drogendijk Rian, who find patents to have a significant positive relationship with FDI inflows.[126] This is particularly interesting compared with results from authors focusing on different regions with similar methods, such as an article by Buckley et al. who did not find a relationship between patents and FDI in case of all Chinese FDI recipient countries.[127] This could imply that acquiring know-how from the EU is of particular interest to Chinese MNEs.

This is not surprising, as some EU countries are leaders in filing for patent applications. Out of the top ten countries with the most patent applications globally, five are European, namely Germany, France, the UK, Italy and Switzerland.[128] The European Patent Office – the organisation responsible for patent applications filed in the EU – is one of the largest in the world[129] and received over 180 thousand patent applications in 2019. Half of these were from European countries, the biggest players being Switzerland, Sweden, Denmark, Netherlands, and Germany.[130] Non-European countries with the largest number of applications among others include the United States, Japan, China, and

[126] Blomkvist, Katarina, and Drogendijk Rian. 'Chinese Outward Foreign Direct Investments in Europe'. *European J. of International Management* 10 (1 January 2016): 343.
[127] Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2010.
[128] World Intellectual Property Organization. 'World Intellectual Property Indicators 2019'. Geneva: World Intellectual Property Organization, accessed 12 January 2020, https://www.wipo.int/publications/en/details.jsp?id=4464. 8.
[129] European Patent Office. 'World's Five Largest Patent Offices Agree on Joint Task Force for Emerging Technologies and AI', 13 June 2019, accessed 22 May 2020, https://www.epo.org/news-events/news/2019/20190613a.html.
[130] European Patent Office. 'Patent Index 2019: Statistics at a Glance', 2020, accessed 22 May 2020, http://documents.epo.org/projects/babylon/eponet.nsf/0/BC45C92E5C077B10C1258527004E95C0/$File/Patent_Index_2019_statistics_at_a_glance_en.pdf. 5.

South Korea.[131] Sectors with the largest number of applications include ITC, medical technology, computer technology, electrical machinery, energy, and transport.[132] Overall, based on the results we can conclude that strategic asset-seeking is an important driver of Chinese FDI in the EU.

One of the most noteworthy results is FDI barriers having a significant impact on FDI inflows. While not surprising, giving the current political climate in the EU, this result implies that the adoption of a screening framework should be an efficient way to tackle unwanted Chinese investments in the Bloc. Currently, each Member State has its own screening mechanism, including both ex-ante and ex-post measures.[133] As member states do not have to opt in, we are yet to see if the measure will be sufficient to protect the strategic interests of the EU. Even if initially not all EU countries will take advantage of the system, it is still likely to become a platform for knowledge sharing, and if successful, could ultimately appeal to more member states. Recent developments related to the Covid-19 pandemic could also encourage more countries to join the framework. In March 2020, the European Commission warned member states to step up their screening efforts and protect sensitive assets, as ‘there could be an increased risk of attempts to acquire healthcare capacities (for example for the productions of medical or protective equipment) or related industries such as research establishments (for instance developing vaccines) via foreign direct investment.’[134] The Commission also contended that ‘[v]igilance is required to ensure that any such FDI does not have a harmful impact on the EU’s capacity to cover the health needs of its citizens.’[135]

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[131] Ibid, 3.
[132] Ibid, 4.
[133] European Commission. ‘Foreign Direct Investment – An EU Screening Framework’, September 2017, accessed 20 May 2020, https://trade.ec.europa.eu/doclib/docs/2017/september/tradoc_156040.pdf.
[134] European Commission. ‘Guidance to the Member States Concerning Foreign Direct Investment and Free Movement of Capital from Third Countries, and the Protection of Europe’s Strategic Assets, Ahead of the Application of Regulation (EU) 2019/452 (FDI Screening Regulation)’, 25 March 2020, accessed 9 May 2020, https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf. 1.
[135] Ibid. 1.

EU-China trade relations will likely deteriorate in the future, and we are already seeing trends pointing in that direction. In April 2020, the China Council for the Promotion of International Trade (CCPIT), China's national agency for trade and investment promotion, published a report about how Chinese companies hold a negative view on increasing FDI restrictions.[136] The CCPIT called on the EU to lift the unreasonable market barriers, stop discriminating against Chinese companies and interfering with companies' order of business. The CCPIT contended that their recommendations serve 'to help the EU solve its problem with its deteriorating business environment caused by excessive overregulation.'[137] The EU screening framework has not even launched yet but tensions are already running high, and it is very unlikely that they will not get worse. Hence, an important takeaway from my results is that paying special attention to the new FDI screening framework should be a priority to the European Commission. The framework has the potential to become the most efficient tool for the Bloc to protect its strategic assets but will also continue causing frictions with China, of which the Commission needs to stay in control. A potential benchmark for this could be the Committee on Foreign Investment in the United States (CFIUS), the organisation responsible for reviewing prospective foreign investments in the US that might affect national security.

Another interesting result is political stability and corruption control being statistically insignificant, implying that institutional factors do not play an as important role in Chinese MNEs' country location choices as we would assume. Buckley et al., who investigated determinants of Chinese FDI to 49 countries, raise an interesting point about

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[136] 'Zhongqi Xuanze Oumeng Zuowei Shuoyao Touzi Mudi de Bili Jiangfu Jiaoda 中企选择欧盟作为首要投资目的地比例降幅较大 [Proportion of Chinese Companies Choosing EU as Primary Investment Destination Declines Sharply]'. *Xinhua Net*, 1 May 2020, accessed 22 May 2020, http://www.xinhuanet.com/fortune/2020-05/01/c_1125931177.htm.

[137] Ibid.

the case of political risk.[138] The authors, who find a significant negative relationship between inward Chinese FDI and political stability, explain their results by Chinese investors viewing political risk differently form firms in industrialised countries. They argue that Chinese investment decisions might not be driven by profit maximisation but by government influence. They also underscore that there are known shortcomings in usual measures of political stability.[139] In case of the European Union, it is also worth noting that even member states that score lower on political stability may be perceived as stable by China – especially since the country is known for its willingness to invest in politically unstable countries, where Western firms are normally not willing to.

My results also show that market growth is statistically insignificant, which could imply that market seeking is not a key motive for Chinese MNEs when it comes to investments in EU member states. Market growth may be insignificant because of the unique nature of the European common market: accessing the market of one Member State allows a company access to not just that country's market but the entire common market.

[138] Buckley et al., 'The Determinants of Chinese Outward Foreign Direct Investment', 2007.
[139] Ibid.

Conclusion

Chinese investments in the EU will likely continue exacerbating fears in the Bloc in the upcoming years, especially in light of quickly deteriorating EU-China relations. While Chinese FDI stock in the Bloc has been declining, it is concentrated in strategically important sectors. FDI protectionism is on the rise in the EU, and the new screening framework is only one of the manifestations of this trend.

The purpose of this thesis was to identify macroeconomic, policy-based, and institutional determinants of Chinese FDI inflows into the EU. To be able to attract more FDI or be able to effectively limit investments in strategically sensitive sectors, member states must have a solid understanding of what factors influence Chinese FDI in the first place. Additionally, it is important to note that Chinese investors' locational choices are closely intertwined with the intentions of the Chinese government, as a large portion of MNEs are SOEs. Growing anxieties in recent years about increasing Chinese influence in the Bloc make research on the topic particularly timely and important.

As an initial step towards gaining a better understanding of Chinese investments, I conducted panel data analysis on FDI flow data from 2005 to 2018. I found that the annual number of patent applications in the host country has a significant positive impact on Chinese FDI inflows, while FDI restrictions have a significant negative impact. Results also show that market growth, political stability, corruption control, and trade relations do not have a significant impact on Chinese locational FDI decisions.

There are three main limitations to this research. First, while the quality and reliability of FDI data have improved a lot in recent years, it is still difficult to obtain reliable statistics. I worked with the most reliable non-governmental database available for public use, but there is always a possibility that data is unreliable. Second, the sample size is quite small – for 28 EU countries and 14 years, the initial sample size was supposed to be 392. However, with missing data and especially with the FDI restriction variable only being available for 24 countries, the sample size shrunk to 200, which could distort the results. Third, as it was mentioned in the discussion as well, it is hard to compare the determinants of Chinese investment between EU countries, since most member states do not differ as much from each other as we would intuitively think.

My thesis leaves ample trajectories for future research. First, it would be interesting to contrast and compare potential differences in investments in the 17+1 Cooperation versus the rest of the EU or the Eurozone and non-Eurozone. Second, the selection of independent variables could be approached from a different theoretical background, leaving plenty of room for exploration of Chinese FDI in the EU. Third, it will also be interesting to see how the FDI screening framework and the EU-China Comprehensive Agreement on Investment (if ever signed) will affect Chinese FDI to the Bloc.

In the future, it will be interesting to see how increasingly tense political relations with China will affect the EU-China trade and investment dynamic and whether protectionist policies will become more widespread in Europe. The findings of my thesis have practical implications for policymakers. The European Commission is on the right track with the FDI screening framework and its focus on sensitive sectors. Once the framework goes into effect, the Commission should monitor its impact closely and try to bring more member states on board. The Commission should also endeavour to enhance the scope of the framework, potentially by using the Committee on Foreign Investment in the United States as a benchmark. It is also important for Brussels to recognise that FDI restrictions are and will continue to be a source of tension with China, and they will affect the Bloc's relations with the country. China is known to leverage its economic weight in its foreign relations, hence the EU needs to navigate this challenge carefully so it does not cause undue economic fallout.

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