EU NEW TRADE POLICY STRATEGY TOWARDS CHINA

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Abstract

In this research work, the author focuses on the analysis of the EU trade policy strategy towards the People Republic of China. The European Union's recent trade policy strategy towards China, which focuses on bilateral market access and involves a strong US-style the confrontational stance is ineffective and short-sighted. Today there exists no genuine dialogue between China and the EU on crucial commercial issues. It is interesting to review the EU's strategy and to propose concrete policy options that will allow it to more effectively promote its commercial interests in China, by focusing on topics that will draw support from Chinese interests and bring greater economic benefits for both parties.. Realistic point is important trends in the trade regime between the EU and China. Trade with China dwarfs any other trade relation Europe has with emerging Asia. Disturbing this relationship would have ramifications for sales, growth and employment. The Chinese government is less concerned today about Western criticisms of China's autocratic system, but the Chinese people have grown more nationalistic and represent a potentially greater threat to commercial relations. The main aim of the paper is the presentation of the EU trade policy strategy towards the People Republic of China.

Keywords: European Union, trade policy, strategy, China, bilateral trade agreements

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Introduction

It is interesting to review the EU's strategy and proposes concrete policy options that will allow it to more effectively promote its commercial interests in China, by focusing on topics that will draw support from Chinese interests and bring greater economic benefits for both parties. In trade in goods, it proposes a "small bargain", involving the granting of market economy status to China in antidumping, in exchange for China's improvement of its WTO tariff schedule implementation. In its "behind-the-border" rules agenda, the proposed EU-China Partnership and Cooperation Agreement could develop a truly "grand bargain" involving a strong reduction of China's highest barriers on inward FDI in services, better access by China to the EU's services markets, joint procedures to address China's Sovereign Wealth Funds' and EU's norms and standards. It would also involve an important scaling down of Europe's requests in issues such as intellectual property rights. More broadly, the EU should review its current trade policy strategy based on bilateral deals and re-focus its trade policy on the WTO. The EU should also adopt a truly global approach in its trade policy towards China. This means involving not only the United States and Japan, but also successful medium-sized industrial and emerging economies.

China and EU Preferential Trade Agreements

The EU common trade policy as foreign policy is given by the proposed preferential bilateral trade agreements with a certain number of Asian countries and also with China. In November 2006, the Commission tabled a working document suggesting the negotiations of a large number of bilaterals (24 including the PCA with China). This was an important change of course in European trade policy strategy away from multilateralism and towards bilateralism.

From an economic perspective, these initiatives are leading both the EU and China into dangerous waters. In sharp contrast to the bilaterals under negotiation or consideration by five other countries (Chile, Japan, Korea, Singapore and the US) the bilaterals envisaged by the EU (and China) are characterized by an initially high level of tariffs and/or non-tariff barriers in goods, and by restrictive regulations in services and investment (Messerlin 2007).

Economic analysis shows that such preconditions are likely to generate strong distortions in trade and investment flows when the bilateral comes into force, to the detriment of the European and Chinese consumers in the short run, and of the European and Chinese producers in the long term.

From a political perspective, a bilaterally-based policy appears to be a major strategic mistake for the EU. First, one may wonder how the EU trade negotiators will be able to extract more concessions from a tête-à-tête with China, when they have been unable to do so in the WTO multilateral forum during the Doha negotiations. By contrast, a trade policy based on bilateral agreements in Asia is familiar to China's diplomacy – it echoes the Chinese an imperial tradition dating back to the Tang and Ming dynasties, when trade agreements were instrumental for the recognition of the political supremacy of Chinese emperors.

Second, a policy based on bilaterals will almost inevitably generate severe intra-EU tensions. For instance, a bilateral with, say, Korea may open the Korean insurance market to a given EU insurer. However, this EU insurer may have preferred preferential market access to (say) Indonesia, and he will be unhappy when an EU competitor will be chosen for entering the Indonesian insurance market, once the EU will have concluded a bilateral with Indonesia.

Last but not least, the EU's focus on bilaterals is likely to raise incentives among Asian countries to negotiate bilaterals among themselves, risking by the same token to marginalize further the EU. One could argue that Asian countries may not need such an additional incentive and that they may be heading to an Asian Economic Area anyway, as Europe did fifty years ago. However, any parallel drawn between Europe and Asia underestimates the differences in initial conditions behind the European and Asian endeavours. First, trade between the EU founding Member States before the EU creation was different – in nature and depth – from the current trade between the Asian countries (Kang 2008). Second, even more crucially, Asian countries do not enjoy the very special political situation that has characterized the EU's endeavour since its inception, namely the fact that the large Member States have always had a roughly similar economic size. In other words, there was no serious threat of supremacy of a large European Member State over the others. This is definitively not the case in Asia. Indeed, the enormous asymmetry in terms of size among Asian economies could only make most Asian countries prefer to see the EU (and other non-Asian countries) maintaining a multilateral approach to trade issues, because it is their best guarantee of economic and political independence (Messerlin and Wang 2014).

It is interesting to discuss means to renew and recalibrate the current and the future EU trade policy strategy towards China. Since 2006, the EU has adopted a bilateral approach and proposes a Partnership and Cooperation Agreement involving the renewal of the agreement concluded by both parties in 1985. The EU's stance towards China has become confrontational at the end of 2007, a strategy that will prove to be counterproductive and damaging (Messerlin and Wang 2014). It proposes an alternative approach to leading talks with China within the context of the PCA: a working strategy for the EU should involve promoting EU interests while attracting support from Chinese interests. The main proposals are:

• In trade in goods, achieving a genuine dialogue with China would involve a "small bargain". The latter would consist in better joint enforcement of China's WTO Protocol Accession: the EU would grant China market economy status in antidumping, and China would improve implementation of its tariff schedule.

• In the behind-the-border rules agenda, the EU-China Partnership and Co-operation could develop a "grand bargain" focusing on the following issues:

• A reduction of China's highest barriers on inward FDI in services.

• An improvement of Chinese access to EU services, with the EU renouncing its right to use the special safeguard included in China's WTO Accession Protocol.

• A joint setup by the EU and China of procedures to address the concerns raised by some of China's Sovereign Wealth Funds' operations and by some EU norms and standards.

• An important cut in Europe's requests on other issues, in particular on intellectual property rights.

• The EU should review its current initiative on bilaterals (in particular, with Asian countries) and re-focus its trade policy on the WTO. Even China would benefit from such a re-balancing. Progress in the WTO would contribute to the emergence of a "Chinese Single Market," whereas bilaterals would favour a deeper segmentation of Chinese provincial markets. The forum provided by the WTO is a buffer for conflicts that bilaterals tend to re-activate, sooner or later.

Such an ambitious EU trade policy towards China has two crucial implications on EU domestic affairs. The first is economic. A powerful way to minimize the concerns raised by China's competition is to improve the functioning of the EU Single Market. This involves a much higher degree of interconnection between the still fragmented European markets, particularly in services, in order to make these markets larger and more competitive.

There is a symmetrical challenge for China as well, namely to continue to improve the functioning of its own domestic markets by deepening liberalization and privatization, and, above all, by generating the institutions required by a sustainable market economy.

The second development is political. The behind-the-border agenda (services, investment, norms, etc) involves deeply the EU Member States. As a result, the EU negotiating machinery as currently designed, with its almost exclusive reliance on the Commission's negotiating capabilities, is not efficient.

Indeed, it generates much frustration among the EU's large trading partners, including China, which does not know whom to talk to. There is, therefore, a strong need to review this machinery (Messerlin and Wang 2008). An important option to consider is, however, the direct participation of the EU Member States in the negotiating teams dealing with those behind-the-border issues crucial for them. A truly global approach such an ambitious program has no chance to succeed if it does not fulfill two conditions: to remain focused on economic initiatives, and to involve other major economies in the process of trade policy dialogue with China. First, it should keep a clear economic focus. In the PCA context, the EU Commission has gone way beyond economic issues (Messerlin and Wang 2014). The other condition is that the EU should combine its actions with other players in the world for example with the USA.

The EU's support for a rapid yuan realignment runs serious risks. This includes appearing inconsistent when combined with the silence on the imbalances within the eurozone or on the US dollar slide or ignoring the worldwide consequences of a possible severe downturn of the Chinese economy (Messerlin and Wang 2008). In fact, an EU-US activity on this issue is largely counter-productive for the US position to the extent that it will almost inevitably reinforce the protectionist camp in Beijing, and sideline the supporters of such a realignment in China. Therefore, the EU would be best serviced by trying to co-ordinate its actions and co-operate with a broader group of countries, not only with the US and Japan (Messerlin and Wang 2008). This is a daunting task.

However, beyond many well-known differences, Europe shares some key similarities with China that could be helpful for such an endeavour. Europe and China have both immensely suffered during the XXth century – from civil wars to costly economic and political mistakes. And, for the decades to come, they will face the same crucial challenge – how to define the best balance between the "central" and "local" authorities in such deeply heterogeneous and very large economies.

The way forward is to involve medium-sized countries, such as Australia, Korea, or Chile. The advantage that this would bring is that these countries are often among the best performers in domestic governance. They innovate faster and better in terms of economic regulations. Not only would their experiences be most useful, but they would also make it politically easier for Chinese interests eager on such best practices required by a well-functioning market economy to promote its adoption in China. As often in critical periods, the past can provide inspiration for the future.

The EU-China International Business Bond

The Open Door Policy was a step-change in the international business relationship between China and the EU, as it paved the way for bilateral foreign direct investment (FDI), which had previously been prohibited across the board. China set up special economic zones and gradually reformed its institutional environment to accommodate and support foreign investors. EU businesses have taken advantage of these changes and have invested significantly in China. Chinese domestic economic growth policy has been built around inward FDI. However, it is now quite possible that Chinese outward direct investment (ODI) will become as important to Chinese economic growth as an inward investment has been in the past. With regard to Chinese ODI, the go global policy initiated in 1999 was the ultimate turning point (Voss *et al.*, 2009). The Chinese Government set out plans to create large, global-leading Chinese firms and reformed the institutional settings to achieve this, while actively supporting equity-based international operations. The EU has tried to take advantage of the new openness of China and has heavily courted Chinese outward investors. To date, our understanding of what attracts Chinese firms to the EU is poor, and equally lacking is our knowledge of what consequences such investments will have for the European economies. Buckley *et al*. (2007) argue that Chinese firms have a greater propensity to invest in risky host countries, which has been made possible by government support (Morck *et al*., 2008). EU member countries rank low in political risk rankings and government-induced investments are not necessarily welcome (see Globerman and Shapiro, 2008) (Clegg and Voss, 2011).

It is interesting to classify the motives for FDI (following Dunning and Lundan, 2008) into: market seeking, efficiency- seeking, resource seeking and strategic asset seeking. This implies that the market to be served might be within the host country or the home country, or located elsewhere within a third country. European investment in China's more advanced eastern provinces has been turning towards market-seeking FDI and away from efficiency-seeking greenfield projects. This follows the growth of income per capita, but also the loss of cost competitiveness in these provinces and thus in their ability to target international markets through export. FDI by acquisition (in liberalized industries) also becomes more likely as Chinese firms themselves become more attractive acquisition targets (Clegg and Voss, 2011).

Focusing on Chinese ODI into the EU, it is far more likely that Chinese investors will use acquisition, as attractive acquisition prospects are relatively more numerous abroad than they are for foreign firms in China. Therefore, whereas FDI into China is predominantly of a greenfield nature, Chinese ODI is characteristically carried out through acquisition in the advanced market economies. The ability of Chinese firms to pay the considerable upfront costs involved with the foreign acquisition has been the subject of enquiry. The type of foreign market entry mode has direct implications for the embeddedness of the foreign investor in the host economy.

Empirical research on Chinese international business has concluded that countries that are geographically, politically, ethnically and economically close to China have stronger international business ties with the Chinese economy (Zhang, 2005) (Clegg and Voss, 2011). In the aftermath of the financial and economic crisis of 2008–2009, mutual benefits are available to both the EU and China, owing to the rise in opportunities for foreign firms to invest in China, and for Chinese firms to invest in the EU and in the crisis- stricken the rest of the world (Clegg and Voss, 2011).

The level of EU investments in China has undoubtedly increased, predominantly in the early 1990s. However, since the mid-1990s, there has been a leveling off of investment, albeit at a high annual level. of FDI (Clegg and Voss, 2011). Both the absolute and relative data indicate that the EU has been a very reliable investment partner to China. Chart 40 enables us to compare this observation with other major economies. The solid line indicating the EU (both EU15 and EU27) can be compared with the long broken line for the USA, and the short broken line for Japan. Over the period 1984 to 2008, there was a reduction in the EU's importance in terms of FDI to China, as indicated above. However, the investment pattern from the EU does not appear to be much different from that of other leading developed countries, such as the USA and Japan. Each of these major investors has enjoyed greater relative contributions to Chinese inward FDI in the past than they do today. However, at the beginning of the period, the EU was considerably below the other two investing countries but ended slightly ahead at its conclusion. This is an indication that the EU has increased its FDI share within China compared with other investors, and this is likely to increase further.

Some recent work on the investment potential for European firms within China has shown how investment can be considerably increased in the coming years. A study produced in 2008 investigated the potential for foreign investment in China's second and third-tier cities; that is, investments outside of Beijing, Chengdu, Guangzhou and Shanghai (UKTI and CBBC, 2008). To date, the bulk of inward FDI in China has flown to the core areas of first-tier cities and eastern provinces. However, following a range of Chinese Government initiatives over the past decade, foreign investors have plenty of scopes to invest further inland within China, into provinces such as Hubei, Inner Mongolia and Sichuan, where growth prospects are strong, operating costs can be low and consumer purchasing power is increasing. Such investment might be export-oriented or, increasingly, oriented towards the high-growth markets of the Chinese economy, which now offers better prospects than many of the investors' home and traditional target economies. We can surmise that the Chinese economy offers one of the most attractive investment prospects available to European multinational enterprises (MNEs), on account of its high domestic growth. The World Investment Prospects Survey by UNCTAD notes an increase in the preference by major MNEs for emerging economies: "No less than nine [emerging] countries feature in the list of top 30 investment locations, among which two (China and India) are in the top five" (UNCTAD, 2009, p. 49). Therefore, it is reasonable to expect EU FDI to China to hold up for the foreseeable future. The rise of Chinese ODI since 2000 poses several "big questions" for enterprises from Europe and their governments and policy-makers and, indeed, for the public at large (see Globerman and Shapiro, 2009; Rosen and Hanemann, 2011).

This debate has been stimulated by the highly visible and large-scale acquisitions of traditional European companies such as MG Rover (UK) by Nanjing Automobile and Shanghai Automobile Industrial Group and Volvo (Sweden) by Geely, or the successful tendering for infrastructure contracts by Huawei in Italy, the UK and the Netherlands. Added to this is the significant increase in China's foreign exchange reserves and the establishment of sovereign wealth funds, such as the China Investment Corporation (Rios-Morales and Brennan, 2011), and the concomitant speculation that Chinese ODI will rise to up to US$ 2tn by 2020 (Rosen and Hanemann, 2011).

Controversy exists over the question of whether the firms that are responsible for Chinese ODI are fundamentally different from their developed world counterparts, and are motivated differently. If so, do we need to consider alternative theories for Chinese ODI? This discussion is stimulated by the assumption that Chinese MNEs are necessarily a breed apart. They emerge from a state-directed economy (Scott, 2002; Huang, 2008) and it has been alleged that they aim to fulfill government policy only (Gottwald, 2011). Assuming for a moment that these differences exist, it follows that the externalities of Chinese investments on the recipient economies should be less positive than those created by developed nation MNEs.

Based on this assessment, it is questionable to what extent the EU should aim to increase its share of Chinese ODI. We need to distinguish at least two broad types of Chinese ODI: (1) that by state-owned enterprises (SOEs); and (2) that by privately-owned firms. Inevitably, the distinction is a fuzzy one, particularly for large private firms that might have some government interest held in them, and for state-owned firms that operate in highly competitive markets. However, the distinction is important when we consider why and how Chinese firms invest overseas.

There is some evidence pointing to the importance of market imperfections in the home Chinese economy, whose effect is to confer particular characteristics and, indeed, advantages on certain Chinese outward investors. Buckley *et al*. (2007) infer from their findings that Chinese SOEs invest in risky host countries as a result of imperfections in capital markets within China, causing a noticeable predilection for riskier markets than their developed world counterparts. The data for this research is, however, specific to that period of Chinese ODI in which it was characteristically the preserve of SOEs. It is reasonable to make this argument for Chinese SOEs, but it is not yet demonstrated, nor tested, for other Chinese enterprises; that is, those in the private sector.

In general, private sector Chinese outward investors have developed their competitive strength based on comparative advantage in the production of price-sensitive standardized products. With regard to more technologically sophisticated products that are differentiated, comparative advantage is less important compared with technological performance. Chinese firms are in the position of choosing whether to continue with their existing business model within China, while trying to upgrade their production and product portfolios to become competitive in more technologically advanced sectors, or whether to invest abroad and attempt to benefit from production within a more advanced market that offers the opportunity to learn, via linkages, from more technologically competent firms.

We now turn to examine in more detail Chinese ODI to the EU. The growth of European FDI into China in the first decade of the 21st century has failed to pick up speed despite a substantial standing stock and progressive liberalization in China. In contrast, in stock terms, the EU-27 remains a very minor part of China's outward investment strategy, with less than 3 percent of China's global total ODI directed to the EU by 2009 (MOFCOM, 2009) (Clegg and Voss, 2011).

It must be emphasised that it is the major European economies that have received the greatest attention from Chinese firms, and that future investment plans are focused on these same economies. In a recent survey of Chinese firms, 11 percent of those sampled have investment projects in the EU, while 15 percent indicated that it was their intention to invest in the EU27 in the future (CCPIT, 2010). EU FDI into China is principally a relationship between the more developed economies of the EU and the more advanced regions of China.

The Chinese FDI stock into the EU mirrors this relationship and has mainly been destined for EU member countries (MOFCOM, 2009; CCPIT, 2010). However, the 12 newly-acceded countries collectively have attracted over 10 percent of the EU's total: a greater proportion than their share of GDP. Individually, 3 countries lead the group: Hungary, Poland and Romania. These transition economies have been especially attractive to Chinese firms, largely because of their deep privatization and liberalization (Hungary), large market (Poland) and business environment (Romania).

An explanation of why the EU receives a relatively small amount of Chinese ODI is offered by Rugman and Li (2007). They argue that in common with MNEs from the developed economies, Chinese investors prefer to target just two regions of the world, rather than spread their investments to all of the possible locations (Rugman and Verbeke, 2004). Therefore, if Chinese firms have a regional focus, rather than a global focus, and should Europe not be one of the top two regions for Chinese firms to target, then investment in the EU will be, inevitably, curtailed. Prima facie, the preferred regions are Asia, the home region, and Latin America (MOFCOM, 2009), although for the cohort of generally smaller firms in the CCPIT surveys, Europe in 2010 and Africa in 2009 were the second most popular destinations after Asia (CCPIT, 2009, 2010). It has to be considered, however, that these data are distorted because of a significant amount of Chinese investments in offshore financial centers, such as Hong Kong and the Cayman Islands, and the under-researched aspect of onward journeying' by Chinese investors (Morck *et al*., 2008; Sutherland and Ning, 2011).

However, there might be other reasons for the small amounts of investment directed towards Europe and these are connected with investment motivation. Generally speaking, Chinese investment in the EU follows the pattern identified for developed world MNEs, withsome additional factors (Ye, 1992; Zhang, 1995). This was not so much the case in the early stages of Chinese ODI (Buckley *et al*., 2008), but Chinese firms learning about the European market, changes to the composition of Chinese investors, changes to the business landscape in the EU, and specific home–host country differences (Wu, 2011) are resulting in growing similarities. Of the common investment drivers, market seeking and market expansion are dominant features of Chinese investments (Hayand Milelli, 2011). The largest industry sector for Chinese investments in Europe is whole sale trade, which accounts for nearly two-thirds ofChinese affiliates (de Beule *et al*., 2011). Another market-oriented investment focus of Chinese firms is the establishment of sales, services and import offices (Buckley *et al*., 2008; Torp*et al*., 2011). The focus on services and wholesale and distribution channels is not surprising given that China is a major exporter of goods to the EU, and such FDI supports the export function of the parent firm in China. Internalizing distribution channels and logistics services, such as the Port of Piraeus (Greece), can reduce imperfections in the distribution system and exclude the (costly) middleman.

This increases the margins for Chinese manufacturers who want to sell in Europe, and for Chinese shipping lines. Sales affiliates are useful in that they perform the function of a listening post for technology, while at the same time allowing the home enterprise to continue exploiting its comparative locational cost advantage. SOEs have followed this type of approach. This focus comes at the expense of investments in manufacturing facilities with local market servicing or exporting intentions. Very few Chinese businesses actually manufacture any products at meaningful scales in the EU. Exceptions are Huawei (UK, telecommunication equipment), Haier (Italy and Hungary, white goods) and Hisense (Hungary, brown goods) (Hu and Gao, 2009; Sun, 2010). These firms are market leaders in China and possess the necessary liquidity and organizational slack to carry more capital-intensive investments through the initial stages.

Investments motivated by accessing strategic assets such as technologies, brand names or distribution channels are often equated with mergers and acquisitions, as this foreign market entry mode provides the acquirer with immediate access to these assets. Chinese firms completed 73 acquisitions between 2005 and 2010. Of these, 56 were acquisitions of businesses that were valued at zero (in euros) at the time of announcement. The pattern of the acquisitions indicates a focus on technology-intensive companies. Such deals are undertaken to strengthen competitiveness and to complement export-facilitating greenfield investments.

Knoerich (2010) attempts to disentangle the motivations behind such deals on both the Chinese and the European sides. He concludes that although there is mutual benefit, the Chinese acquirer gains a means of efficiently allocating capital in more productive and higher return ventures, strengthens its internationalization, and accesses advanced technology. This last benefit is further supported by the opening by Chinese firms of R&D offices across the advanced economies of the EU. The industry sectors in which such offices are established reach from telecommunications, mobility concepts and consumer electronics, to acoustic equipment. They typically function as listening posts to ensure awareness of the latest trends in the industry, and are also used to explore and develop new technologies and products, thereby taking advantage of human capital in Europe (Di Minin and Zhang, 2010).

In addition to these common causes for cross-border direct investments, an institutional arbitrage strategy can be observed. Following such an approach, Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments. Such environments, like the EU, might lack the rapid economic growth recorded in China, but they offer greater planning and property rights security, as well as dedicated professional services that can support business development (Witt and Lewin, 2007; Wu, 2011).

The amount and scale of Chinese ODI to the EU is limited. From a European host economy perspective, Chinese FDI is of very minor importance if expressed as a percentage of total inward FDI. Up until 2009, Chinese FDI added up to less than 1 percent of the total flow of inward FDI into the EU27 from the world at large. For the EU advanced economies, this overall pattern is repeated at the level of the member state. Denmark, with 5 percent (in 2008) of its total inward investment coming from China, recorded one of the highest proportions, while Luxembourg held some 2 percent (in 2006). In Finland, the equivalent figure was 1.3 percent. This picture, however, becomes more interesting when we consider the newly acceded countries of the EU. In 2003, Romania was the recipient of a very significant inflow from China, equivalent to 13 percent of its total inward investment. Notwithstanding this scale, a common feature appears to be that these investments cannot be said to form part of a deliberate and focused investment strategy by Chinese firms within the EU. On average, EU member states rarely receive more than 1 percent of their annual inward FDI flows from China. The number of Chinese affiliates within the EU is also commensurately low.

Table 1: Affiliates and Their Employees with Chinese Parent Firms (including Hong Kong) in the EU, 2003–2007

		2003	2004	2005	2006	2007
Bulgaria	Affiliates	59	41	20	25	a
	Employee	411	252	165	200	a
Czech Rep.	Affiliates	0	11	9	9	
	Employee	0	a	a	a	a
Estonia	Affiliates	1	0	0	0	0
	Employee	a	0	0	0	a
France	Affiliates	24	38	61	61	a
	Employee	a	a	a	a	a
Italy	Affiliates	0	0	2	17	27
	Employee	0	0	a	268	311
Latvia	Affiliates	1	2	1	a	0
	Employee	3	12	2	a	0
Lithuania	Affiliates	17	24	28	25	a
	Employee	135	178	245	a	a
Netherlands	Affiliates	0	0	7	a	10
	Employee					407
Portugal	Affiliates	0	0	1	1	2
	Employee	0	0	a	a	a
Romania	Affiliates	a	18	17	31	37
	Employee	a	1217	999	1404	a
Slovenia	Affiliates	14	17	a	21	20
	Employee	48	61	a	64	74
Sweden	Affiliates	15	16	15	16	19

Notes: Data for other EU countries are not available.'a' indicates missing or confidential data. Last update: 25 January2011.
Source: Eurostat(2011c).

The distribution of Chinese affiliates located in the EU, specifically those countries for which we have data, shows that Chinese investment is spread across all member states, with the largest, albeit low, number of affiliates reported for France and Slovenia (seeTable 1).

The limited number of Chinese affiliates suggests that the employment effect of Chinese firms is limited (Hayand Milelli, 2011). Employment data reveal that Romania heads up the EU as a target country in terms of employees per firm. For a new member state like Romania that offers relatively cheaper labor and is in need of foreign investment to support its economic growth, Chinese investments can be invaluable. The situation is likely to be different for those European manufacturing firms that were acquired out of administration,or when in economically dire situations, by Chinese firms. Here, a relocation of production facilities to China is likely, as was the case after the acquisition of MG Rover by the Shanghai Automotive Industry Corporation and Nanjing Automobile (Hay and Miletti, 2011).

In view of the empirical evidence that the EU is not a favored location for Chinese investment, and the theoretical argument that Chinese firms might be expected to preferentially invest in just two regions in the world rather than three, does the EU have any policy options to encourage Chinese firms to invest? Egger and Pfaffermayer (2004) suggest that the EU would need to initiate some major project in order to have a tangible effect onChinese investors' preferences. Such a project might yield benefits at the point of being announced, as long as it was a credible initiative. In addition, barriers that remain between member states could be eliminated, resulting in a more integrated EU market and making business easier within and between member states. If the EU were to resemble more the internal market of the USA and the EU were as open and welcoming to Chinese businesses as the USA and Southeast Asia are currently, this might lead to a change in Chinese attitudes towards investment in the EU (CCPIT, 2010). The nature of the strategic intent of Chinese investments will continue to evolve to resemble more closely that of developed world MNEs (Buckley *et al*., 2008).

Following the Treaty of Lisbon, the EU has competence for FDI policy as well as trade policy: a competence that it has enjoyed since the 1960s. This means that, as with tradepolicy, the European Commission is now empowered to negotiate with third countries onbehalf of the Union as a whole, in contrast with the position before the Treaty when EU members were free to generate their own individual policies towards both inward andoutward direct investment (Karl, 2004). Prior to the Treaty, member states might have considered employing international investment agreements (IIA), which could be established on a bilateral basis to enhance the level and the quality of inward FDI. Although member states are no longer able to do this individually, it is within the competence of the EU to establish these sorts of agreements on behalf of the EU with third countries. IIA come in two forms: bilateral investment treaties and preferential trade and investment agreements, the latter having a coverage that is broader in terms of economic cooperation. There is some evidence that preferential trade and investment agreements do influence inward investment; however, bilateral investment treaties do not seem to contribute much to our understanding and the precise nature of their effect still remains unclear. UNCTAD (2008) reports on a survey that reveals that only a minority of IIA include provisions explicitly on investment promotion. In fact, the intention of most IIA is to protect those investments that already exist, and not to stimulate new investment in response to liberalization, such as pre-establishment national treatment provided for by promotional agreements. Even so, IIA often signifies that the contracting parties are hopeful of an increase in FDI (Clegg and Voss, 2011).

The EU–China international business bond is based generally on trade, which primarily involves exports from China to the EU. Not surprisingly, our analysis suggests that it is Chinese firms that are today in the ascendant as foreign investors. The considerable foreign exchange earnings of Chinese exporters mean that they have ready funds for foreign investment. Investment opportunities for Chinese firms in the EU include market-seeking opportunities,but this motive is probably still best discharged through exports from China. If Chinese firms are to invest substantial amounts within the EU, then it is more likely that they will seek to make investments to promote trade from China, and to purchase strategic assets within the EU. Such strategic assets rest within the knowledge and technology pool created by Europe's leading international and global firms, and their European suppliers. Knowledge is best accessed at its place of origin.

Should the EU succeed in making policy changes so that its business environment is more attractive to Chinese investors (and, of course, to other non-EU investors), then the rate of Chinese FDI to the EU could ramp up considerably, as there is no doubting the capacity of Chinese firms to invest, as indicated by Rosen and Hanemann (2011). As to the precise complexion of Chinese ODI, this depends on the composition of investment flows,and this tends to be a function of a country's industrial strength and resource dependency.The state-owned investors, which were the first to invest abroad, are now joined by agrowing cohort of privately-owned firms. Their motives might be different, and their attitudes to risk might also differ. The SOEs, for the most part, still enjoy access to capital on preferential terms from within the Chinese economy. These firms might have a greater interest in diversifying their real asset portfolios, possibly across different industrial sectors,as well as across countries. The private sector investors, in contrast, tend to be quite focused on particular industrial sectors and, therefore, their expansion strategies are more likely to be aimed at developing a single line of business (or relatively few).

Conclusions

The EU common trade policy as foreign policy is given by the proposed preferential bilateral trade agreements also with China. It must be emphasised that on a theoretical level, understanding the choice of trade policies between liberalism and protectionism in EU and China is very important. In many areas, China in foreign trade possesses comparative advantages. With new investments, a country can transform its position through industrial expansion at home and sustain it through international trade. With bilateral trade agreements between two partners, services will be more traded and trade policies will have to adjust to changes in the organization of global value change. China may continue its development to specialize in innovation, especially in electronics and increasingly in services and knowledge-based economy. China is especially sensitive to the advantages of intensive growth and will not wish to disrupt essential economic arrangements that have been crucial to her success.

Both types of Chinese enterprise seek strategic assets, including technology and distribution channels,through the purchase of European firms. However, to the extent that Chinese firms are seeking growth through production-oriented FDI, the EU, with its overall slow growth andcomplex business and political environment, still offers a less attractive market than China itself, with the possible exception of the small and lower cost economies of certain Fifth Enlargement countries within the EU. The surest way for the EU to encourage inward investment is to make doing business on a pan-European basis as easy as possible. Recent EU policy initiatives might signal that the EU, finally, will be speaking and acting with one voice on this crucial issue for the EU–China FDI bond.

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