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Chinese investment trends in Europe

2016-17 Report

Author: **Ivana Casaburi**

Promoter:

Cuatrecasas, Gonçalves Pereira

Collaborators:

Catalonia Trade & Investment

Generalitat de Catalunya
Gobierno de Cataluña

Ajuntament de Barcelona

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Foreword

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China is currently living a pivotal moment of its modern-day economic trajectory, transitioning from its position as a middle-income country to that of a high-income country. This process entails furthering the changes gradually introduced in the Asian nation since the onset of the liberal period initiated by Deng Xiaoping in the 1980s. More specifically, it calls for a new wave of reforms to afford market forces greater space and open up the capital account to the outside world, while moving towards a growth model in which high value-added services and manufacturing, inter alia, play a larger role.

The transition requires the business arena to take a *great leap forward* in terms of its competitive capabilities, and to become the springboard for economic transformation. Access to those capabilities will be via two different approaches. On a domestic scale, this will involve driving the knowledge economy through initiatives such as Internet Plus, electric vehicles or the cyber economy, as laid down in the 13th Five-Year Plan (2016-2020). Internationally, both state-owned and private Chinese firms are being forced to invest in sourcing capabilities that are still meagre within China.

The European Union could play a key role in the latter case, by supplementing and providing these capabilities. Now more than ever, Chinese companies need to acquire technology, knowledge and specialisation – factors that are heavily present on the European scene. For this reason the European Union, as well as being China's main business partner worldwide, has now also become the principal recipient of Chinese firms' investment. In 2015, China's investment in the European Union exceeded USD 30 billion for the first time, which is double the amount invested in the United States.

In what is a turbulent period for Europe, bringing major challenges such as the refugee crisis, the rise of Euroscepticism and Brexit, consolidated and increased investment from China is excellent news. Chinese investment is targeting the European Union more than ever before, in view of the numerous advantages this market presents for the Asian country's funds: companies up for acquisition or with which to form alliances, operating at the high end of the value chain; talent; a major consumer market; regulations that allow for foreign investment; and considerable institutional, political and macroeconomic stability.

The third edition of the ESADE China Europe report encompasses a thorough, in-depth analysis, in two parts, of this new economic reality. Part I analyses the major challenges China must address in reshaping its economic model, and the current status of significant initiatives undertaken by the Chinese government that affect the country's positioning in the global arena, such as the "One Belt, One Road" strategy, the new multilateral institutions launched by China (Asian Infrastructure Investment Bank and New Development Bank) and the internationalisation of the yuan.

Part II examines the recent transformation in the pattern of Chinese investment worldwide, including a comparison of investments in the United States and in Europe. In particular, it focuses on China's investments in the European Union, with emphasis on four southern European countries: Italy, Spain, Portugal and Greece.

I hope you will enjoy reading this report, which is now acknowledged internationally as a benchmark study of Chinese investment in Europe, and which is the fruit of a joint effort led by ESADE Business School and ESADEgeo, with the collaboration of other partners and friends such as Cuatrecasas, Gonçalves Pereira, ACCIÓ-Catalonia Trade & Investment and Barcelona City Council.

Javier Solana,
Chairman of ESADEgeo

Executive summary

Executive summary

For the third year running this report reflects the results of ESADE's study of foreign investments made by Chinese firms, a phenomenon that has been influenced by the measures implemented to change China's economic model, and the ensuing slow-down in GDP growth. Both of these factors have served to drive foreign investments, enabling China to post a new record at the end of 2015. Within this context, Europe has consolidated its position as a priority recipient of the funds invested by Chinese companies, which are displaying their sustained and growing interest in Southern European countries, notably Italy, Spain, Portugal and Greece. The main conclusions drawn from the study are set out below.

• The slow-down in GDP growth in the Asian economy has stabilised, with the **economy now moving towards rates of between 6.5% and 7%** (6.9% in 2015 and 6.7% in the first and second quarters of 2016). While double-digit growth rates are now a thing of the past, **China continues to be the major driving force of the worldwide economy,** accounting for 15% of global output.

• The **three-way transition in China's growth model** is still underway: **private consumer spending is making headway** (from 35.9% of GDP in 2011 to 38.2% in 2015) while public investment is dropping back (from 47.3% of GDP in 2011 to 45.3% in 2015) ; the **services sectors are expanding** (44% of GDP in 2013 compared with 50.4% in 2015) while the relative weight of manufacturing is on the decline (43.7% of GDP in 2013 compared with 40.5% in 2015) ; and firm **steps towards a more technology- and knowledge-orientated economy** are being taken (with R&D expenditure representing 2% of GDP in 2014).

• **The main risks currently confronting the Chinese economy are the debt and overcapacity** of its state-owned enterprises, which various estimates place at somewhere between 250% and 300% of GDP, and the exposure of its financial system to those risks (80% of bank loans are granted to SOEs). To address this challenge the government has launched an ambitious programme of reforms.

• China has **initiated the 13th Five-Year Plan (2016-2020)**, which aims to achieve a "moderately prosperous society" **based on average economic growth of 6.5% from 2016 to 2020, and to double per capita GDP by 2020 compared with 2010**. In the economic and business sphere, the Five-Year Plan focuses on driving change in the growth model through different programmes such as "Internet Plus" or "Made in China 2025".

• This Asian nation continues to implement a decisive and ambitious expansive strategy in order to **increase its capacity to influence the world economy**, through major initiatives such as One Belt, One Road, the launch of two new multilateral banks backed primarily by Chinese capital **(Asian Infrastructure Investment Bank and New Development Bank)** and **the internationalisation of the yuan**.

• **China's position as a worldwide leader in the foreign investment stakes holds strong:** on an international scale, its firms have invested three times more than the worldwide average in the last decade. Chinese foreign investment beats new records year after year, **reaching an all-time high of USD 127.56 billion in 2015**. This denotes growth of 3.6% compared to 2014 based on UNCTAD data.

• In 2015 and 2016 a **consolidation of trends** in Chinese foreign investment was seen. **Investment in the advanced manufacturing and services sectors grew**; more funds were channelled into **Europe and the United States** than in emerging countries; **while investments made by privately-owned enterprises (POEs)**, which already concentrate 39.8% of the total amount, increased in proportion to funding provided by state-owned enterprises (SOEs).

• Chinese firms stepped up their backing of the European Union in 2015, posting a **new investment record of USD 31.38 billion** (approximately €28.61 billion), which represents **growth of 55% on 2014**. We estimate that in **2016** China will continue to invest strongly in Europe, surpassing the **USD 33 billion** mark.

• **In 2015 Chinese investment in the European Union exceeded the volume channelled into the United States** (USD 31.38 billion in the EU compared with USD 15.3 billion in the US). **In Europe, the energy and logistics sectors** receive the bulk of Chinese investments, while **in the United States technology firms** are favoured. Moreover, **Chinese state-owned enterprises play a greater role in Europe and investment in state-owned assets is more prominent on this continent** than in the United States.

• The European Fund for Strategic Investments (EFSI), better known as the Juncker Plan, and the long-term **Horizon 2020 initiative could serve to stimulate Chinese investment in Europe**, going hand-in-hand with Chinese investment strategies such as **One Belt, One Road**. Regarding the United Kingdom's departure from the European Union following the 2016 referendum, Chinese investment in the UK is not expected to decline in the medium and long term, and in any case not all transactions would be equally affected by Brexit.

• Two countries were head and neck above the rest as recipients of Chinese investment in Europe in 2015, in view of two major transactions. **The first-ranking recipient of Chinese funds in 2015 was Italy**, which received USD 10.31 billion (32.9% of the total investment in Europe) in the largest transaction seen in Europe to date: the acquisition of the tyre manufacturer Pirelli by China National Chemical Corp (ChemChina). **Ireland was second in line**, in view of the HNA aviation and transport group's purchase of the aircraft leasing firm Avolon, a transaction with a price tag of USD 7.6 billion.

• As a reflection of China's interest in acquiring technological capacity and greater specialisation through investments in advanced countries, **the manufacturing sector was the primary recipient of Chinese investment in the European Union in 2015**, amassing 39.4% of the total (USD 12.38 billion), **followed by the logistics and transport industry** (USD 8.12 billion, 25.9%) **and the real estate sector** (USD 3.2 billion, 10.6%).

• **Southern European countries have become more attractive** to Chinese investors in recent years, already racking up 28.3% of total cumulative Chinese investment for the 2010-2015 period, positioning them as **the second most appealing group of European countries for Chinese firms** after the Big Three (United Kingdom, Germany and France). **China has shown greater interest in channelling funds into these countries than other international investors**. While 12.8% of total foreign investment in Europe is concentrated in Southern European countries, this proportion climbs to the aforementioned 28.3% if Chinese investment alone is considered.

• Of the four Southern European countries, **Italy attracts the most complex Chinese investment**, encompassing an extensive range of transactions and economic sectors. It is also the European Union country into which China funnelled the bulk of its investments in 2015.

• **Spain was the last major European economy to receive Chinese funds**, although at present investments are progressing at a fast pace, exceeding USD 2 billion at the end of 2015 in terms of cumulative investments since 2010 – more than double the 2014 year-end figure.

• **In Portugal, transactions conducted as of 2015 have entered a new phase**, which sees the consolidation of the intense inbound investment and positions this country in the sixth slot with respect to Europe as a whole. Moreover, Chinese investors are showing increasing interest in both the public and private sectors.

• Finally, Chinese investments in **Greece** have been concentrated in a promising transaction with considerable strategic implications: **COSCO Shipping Group's investment in the Port of Piraeus**.

Ivana Casaburi, Ph.D.
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of the ESADE China Europe Club

PART I

The China of the future: challenges and initiatives

PART I

The China of the future: challenges and initiatives

Charts and tables

1. Soft landing and about-turn in the economic model

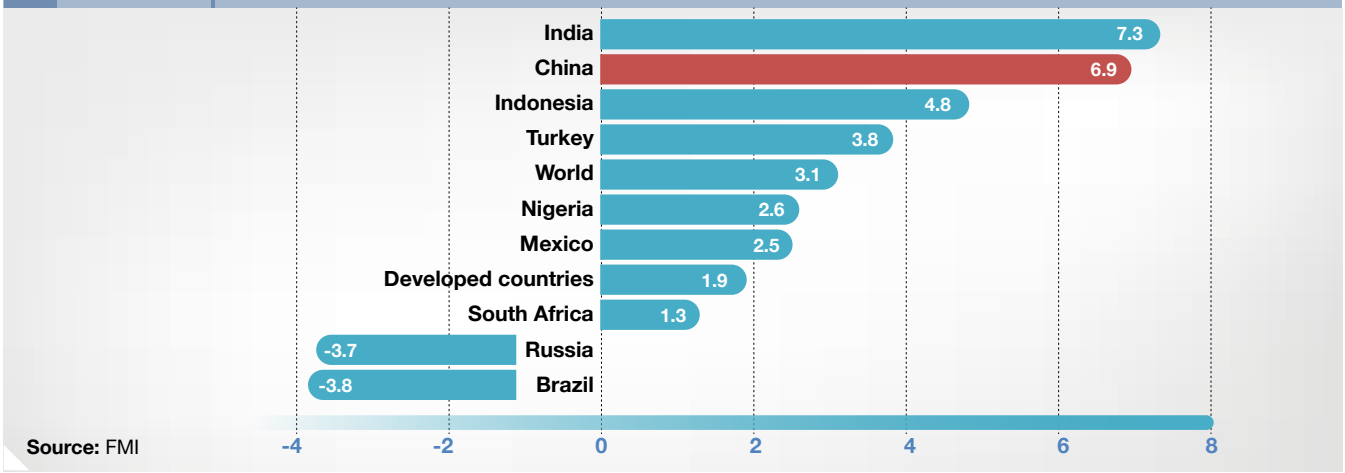
In the last edition of the ESADE China Europe report we mentioned that sources of growth in the Chinese economy were diminishing, leading the country to post more modest growth rates. In 2015 the economy slowed down further – expansion was 6.9%, five-tenths of a percentage point less than in the prior year. This downward trend continued into 2016, with first-quarter growth of 6.7%. The Chinese economy has stepped into a *new normal* characterised by a lower growth rate coupled with an about-turn in its economic model, shifting from public investment to consumer spending, and from industry to services.

The era of 10% annual growth in China is now a thing of the past. However, the growth rate is still high, whether in comparison with other OECD countries or with emerging economies. in the case of OECD countries, China's growth rate was between three and four times faster in 2015 than in the European Union (+2%) and the United States (+2.4%). As regards emerging economies, Brazil and Russia reported a decline in economic activity of 3.8% and 3.7%, respectively, while Mexico and South Africa grew 2.5% and 1.3%, respectively. Amongst the major emerging economies, only India, with expansion of 7.3%, exceeded China (see chart 1).

In short, the Chinese economy continued to demonstrate enviable growth with respect to the other major economies and in no case should the current deceleration be interpreted as a loss of relative weight or relevance for China vis-à-vis the worldwide economy as a whole. Its total output, as illustrated by chart 2, already amounts to 15% of global GDP.

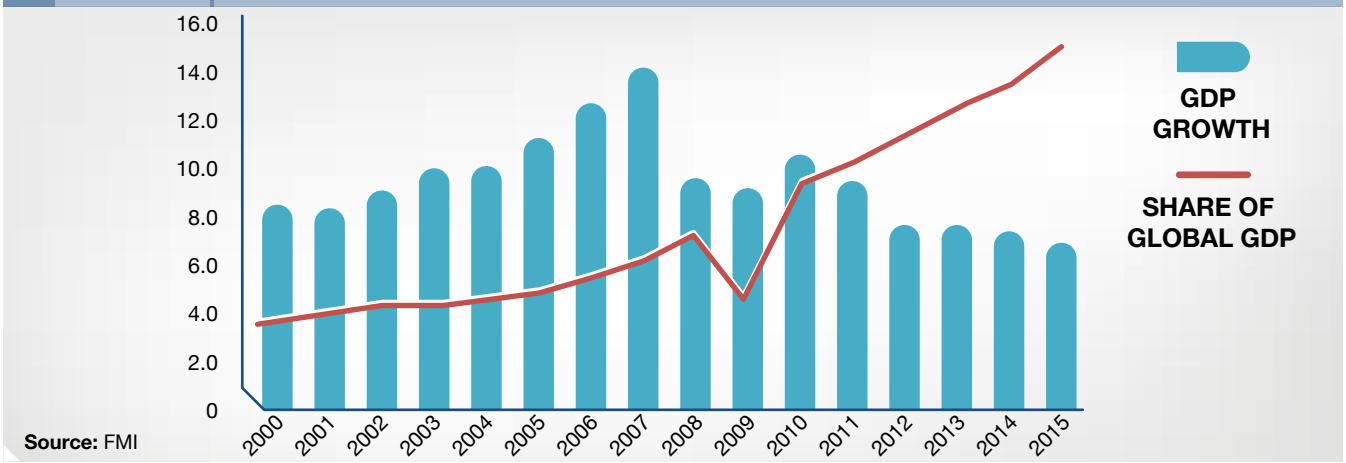
In a context marked by depletion of the old sources of economic growth and a slow-down in activity, a question arises: is the Asian economy moving towards a new economic model that will enable it to lay the foundations for more balanced and sustainable growth in the future? This matter is of great interest and should be addressed from a threefold perspective. Firstly, as regards the components of GDP, an analysis of whether we are seeing a shift away from public investment and towards private consumer spending should be performed. Secondly, with respect to sectors, the question of whether the mix is moving away from industry and towards services should be

Chart 1 Comparison of 2015 GDP growth in selected economies



Source: FMI

Chart 2 Chinese GDP and its share of global GDP according to the IMF (2000-2015)



Source: FMI

asked. Thirdly, from a more horizontal perspective, progress in the shift from labour-intensive activities towards knowledge- and innovation-based activities should be analysed.

Regarding the first of these perspectives, existing indicators show that the components of GDP are indeed undergoing a transformation, which would suggest that sources of growth are being redefined. Public investment has been on the decline, representing 45.3% in 2015 as opposed to 47.3% in 2011. This adjustment is significant, even if it is occurring more slowly than desired. The relative weight of public investment in the EU is 18.4%, compared with 19.7% in the United States[1]. A reduction in public investment is pivotal if debt and overcapacity in the Chinese manufacturing sector is to be reversed. These factors have reached alarming levels, as we will see below.

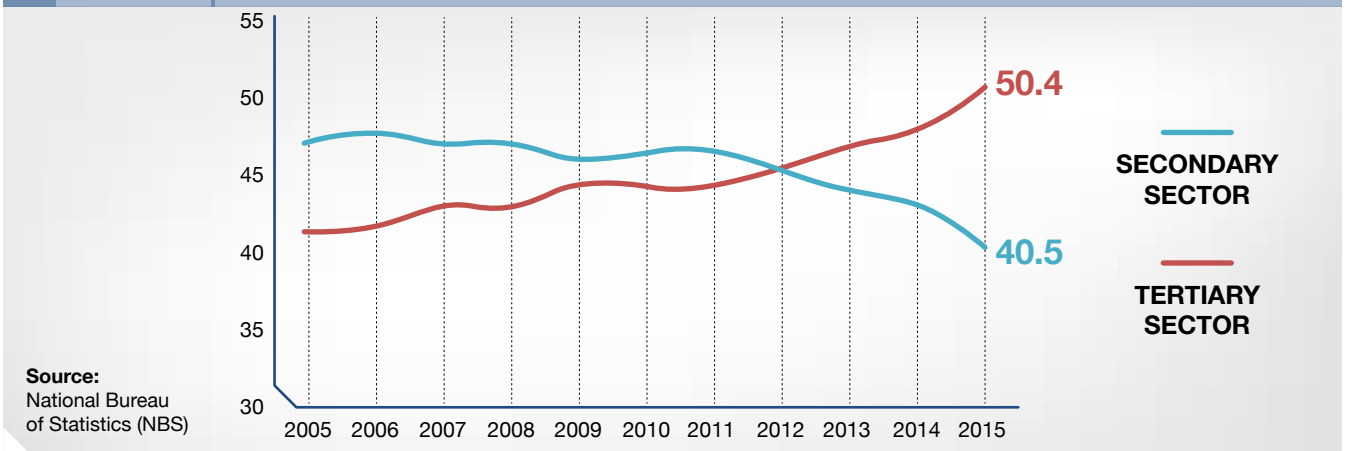
Private consumer spending, meanwhile, has climbed from 35.9% of GDP in 2011 to 38.2% in 2015[2]. This boom in private consumer spending reflected in official statistics is supported by various business activity indicators published throughout the year. For example, Huawei[3] achieved record local sales in 2015 and last year's Singles Day bumped Alibaba's sales up by 60% in one day alone, to USD 14.3 billion[4]. The expectations of international companies operating in the Chinese market also increasingly envisage a rise in private consumer spending in China. By way of example, the Spanish textiles multinational Inditex multiplied the number of its Zara stores from 101 to 165 in 2015, while the Swedish firm H&M's store count climbed from 82 to 291, and stores of the Japanese firm Uniclo proliferated from 80 to 306[5].

Over the last decade there has been a shift in the sectors of the Chinese economy as a reflection of the restructuring process ongoing there, which has seen the manufacturing activity reduce its contribution to the GDP, while services have increased theirs[6-7]. Internal challenges, such as industrial overcapacity, have been exacerbated by the slowdown in the Chinese economy and weak global demand. As a result, the share of China's total GDP attributable to the secondary industry (which includes manufacturing, mining, construction and public services) dropped from 43.7% in 2013 to 40.5% in 2015, while the tertiary (services) sector increased its share from 44% to 50.4% in the same period (see chart 3).

Different service subsectors are fast making headway, driven by greater disposable income and a higher standard of living. Commercial activity is growing substantially on the back of the e-commerce boom, which generated turnover of USD 589 billion in 2015 and in turn originated considerable activity in the logistics and transport sector, which expanded by 4.6% in 2015. Liberalisation of interest rates and the capital account has boosted demand for financial services, which grew by 15.9%. Demand for healthcare and education services has also escalated, as is likewise the case for restaurants and hotels (+6.2%) (see chart 4).

The transformations on the supply side and the demand side feed off one another, creating a vicious circle. As their income levels rise, Chinese consumers are becoming more sophisticated, cultured and interconnected, as well as more demanding. In many aspects, they have adopted consumer patterns that until now were more typical of western countries. This factor directly influences the market performance and competitive dynamics of firms supplying value-added products and services, while stimulating business activity in order for such services to be rendered. This in turn speeds up the redefining of the sector mix required by the supply side.

Chart 3 Transformation of the growth model (2000-2015)



Source:
National Bureau of Statistics (NBS)

1 http://www.economywatch.com/
2 "Walled in: China's great dilemma". Goldman Sachs. 2016.
3 http://www.reuters.com/article/us-huawei-results-idUSKBN0UK08U20160106
4 http://economia.elpais.com/economia/2015/11/11/actualidad/1447222805_516453.html
5 "China's shift to services. A commercial property perspective". Blackrock. 2015.
6 "China Outlook 2016". KPMG Global China Practice. 2016.
7 "China's shift to services. A commercial property perspective". Blackrock. 2015.

Chart 4 Year-on-year growth by economic sector (2015)

Source: National Bureau of Statistics (NBS)

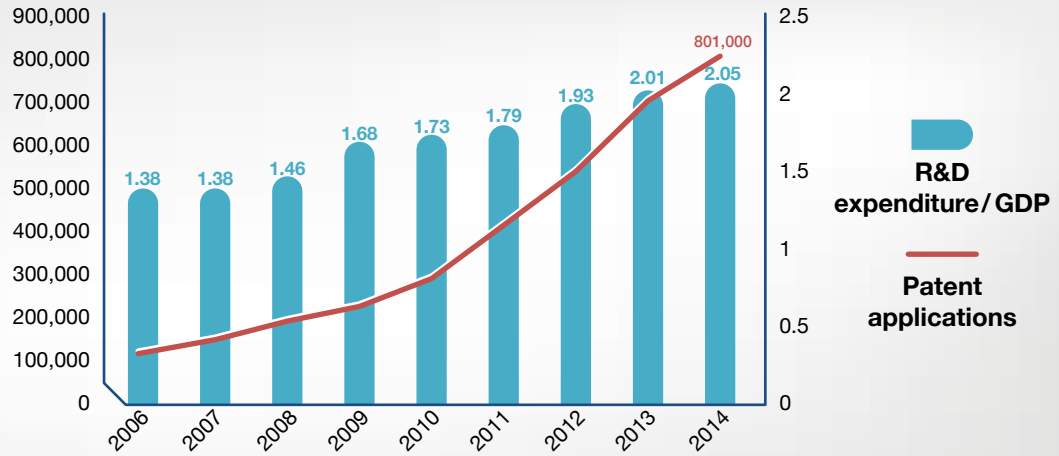
As regards the third perspective, available indicators show that technology and innovation have been making considerable headway in China in recent years, even moving ahead of certain advanced countries in some cases. These indicators leave not a shadow of a doubt as to the direction the Chinese economy is taking and the government's determination to turn the country into an innovation powerhouse. R&D investment in 2014 was 2%, surpassing the EU average and equal to 40% of the volume invested in the United States that year. China is the most prolific publisher of articles in scientific magazines specialising in computer science and chemical research; the number of patents registered rises by 20% annually; this Asian country is already involved in 37% of worldwide exports of hi-tech; and each year it turns out more than one million engineering graduates.

The transition towards a more knowledge-based output scenario with a more prominent added-value component is being led by a select group of major Chinese firms competing at global level. These include Huawei, Lenovo, Tencent, Alibaba and Baidu, all of which are examples of innovative business models that champion R&D investment. Huawei invested USD 6.6 billion in R&D in 2014 alone, not far off the USD 8.1 billion R&D expenditure of US firm Apple[8-9]. Moreover, foreign multinationals are increasingly opting to develop a greater number of innovative business models and products in China, in line with this country's newly developed capabilities. The number of R&D centres owned by foreign companies already totals 1,300. In many cases these have been adapted from basic manufacturing and assembly points, one example being the British pharmaceuticals firm GSK, which has set up its new neurodegenerative disease research base in China.

The transformation of the Chinese economic model is underway. Whichever the indicator used, it is evident that China is taking firm steps towards a remodelling of its growth sources, paving the way for more balanced and sustainable growth in the long term. The economic transformation process is undeniable. As such, it is worth examining the extent and scope of this process in a country the size of China and with the distinctive features of this country's geography. The transition in the economic model is a nationwide occurrence, but is taking place at different rates, which is aggravating the interprovincial imbalance. In recent years, the gap between regions that concentrate their economic activity in mining and quarrying industries and labour-intensive manufacturing sectors, and those in which new sectors are flourishing, has been widening at breakneck speed. By way of example, in cities that play host to a high concentration of the country's most cultured, sophisticated and demanding consumers, such as Beijing and Shanghai, services already represent 77.9% and 64.8% of GDP, respectively; whereas the inland city of Chongqing and the north-eastern city of Shenyang, both of which have a marked industrial component, continue to account for 46.8% and 45.5% of GDP, respectively[10]. Furthermore, while it is true that R&D indicators have improved hugely, they are principally a measure of expenditure by the government and by technological giants such as Huawei, Lenovo and Tencent. Nonetheless, a shift in the production structure towards activities that incorporate greater added value and innovation will call for more openness in a greater portion of the business arena, currently made up of over 77 million companies, many of which are small enterprises located in the lesser-developed inland provinces[11] .

8 http://qz.com/374039/huaweis-rd-spend-is-massive-even-by-the-standards-of-american-tech-giants/
9 http://bgr.com/2015/11/30/apple-vs-google-r-and-d-spending/
10 "China's shift to services. A comercial property perspective". Blackrock. 2015.
11 See: http://www.chinacheckup.com/questions/companies-in-china

Chart 5 Research and development expenditure and patent applications (2006-2014)



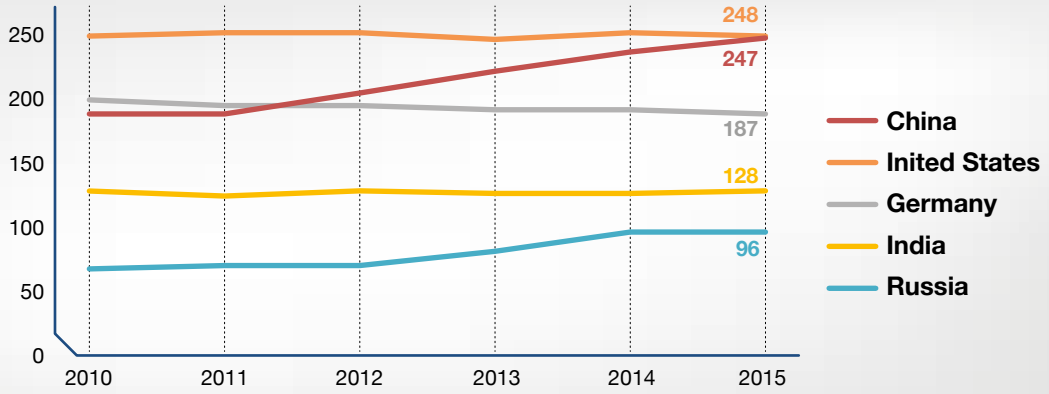
Source: World Bank and OECD

2. New China's greatest challenges

China's development success story of recent years and decades has mainly been prompted by public investment funnelled in from Beijing. However, the investment-driven development model has been implemented on such a large scale that it has resulted in considerable debt and overcapacity in certain economic sectors. The problem has escalated to such proportions that it has become one of the primary roots of uncertainty as regards China's future economic performance.

Public investment was stepped up exponentially in view of the stimulus plan devised to address the subprime mortgage crisis that emerged in 2008, to the tune of CNY 4 trillion (USD 586 million), 72% of which was invested in infrastructure and real estate projects, putting additional pressure on debt. The rapid upsurge in Chinese public debt led to ratios of between 250% and 300% of GDP in 2015, way above those of other countries such as India (128%) and Germany (187%), as illustrated by chart 6. Notably, the debt burden is distributed unequally amongst the different economic agents. Central government debt remains moderate, estimated at 44% of GDP, while corporate debt represents 150% of GDP. However, the potential debt of the Chinese government could be much higher in view of its considerable exposure to SOEs, many of which are experiencing financial problems arising from surplus capacity and the fall in demand. The financial position of public accounts and the impact that the 106 SOEs controlled by the central government could have on these accounts are particular cause for concern. Some of these SOEs – such as the oil companies China Petroleum & Chemical Corporation (SINOPEC) and China National Petroleum, the construction company China Railway Engineering and the telecommunications firm China Mobile Communications – rank amongst the largest enterprises in the world. As illustrated by chart 7, SOEs continue to be eminently more significant than POEs in what are still strategic sectors for the Chinese economy[12].

Chart 6 Total debt as a percentage of GDP in selected countries (2010 - Q3 2015)

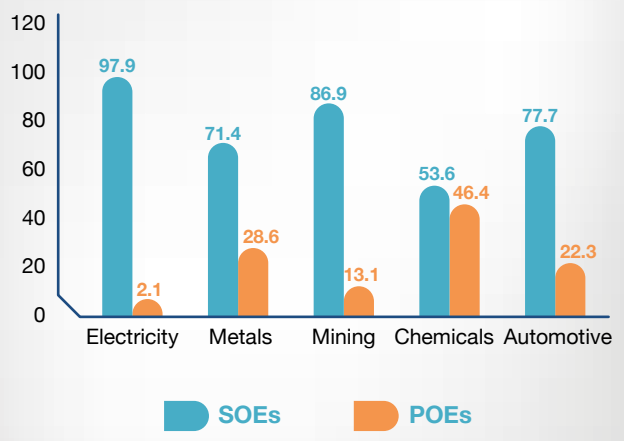


Source:
Bank for International Settlements

[12] "Challenge Ahead in China Reform of State Owned Entreprises". Wendy Leutert. Brookings Institution. 2016

As the main executors of the investment-driven policy, SOEs are currently afflicted by a serious problem of overcapacity. In the cement sector, calculations indicate that China used as much cement (6.6 gigatonnes) between 2011 and 2013 as the United States in the whole of the 20th century; while China's current steel industry output is double that of Japan, India, the United States and Russia combined. The Asian nation has all of this installed capacity now, but demand is on the decline, due to both a slow-down in domestic activity and lesser external demand. An additional problem arises in the form of these companies' scant productivity and capacity to generate profits: the ROA ratio of Chinese SOEs is just 33% that of private firms and 50% that of foreign companies[13]. The debt-to-equity ratio of these companies is therefore barely sustainable.

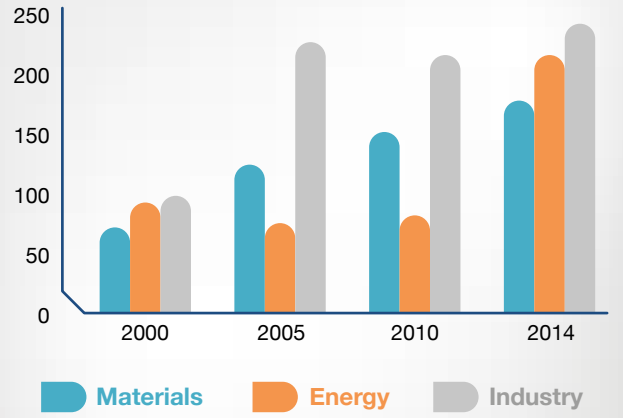
Chart 7 Distribution (%) of asset stocks between SOEs and POEs in selected sectors (2014)



Source: National Bureau of Statistics (NBS)

Finally, we cannot play down the risk that the current situation bears for the financial sector (see chart 8). It is estimated that up to 80% of the total volume of bank loans currently outstanding in China have been granted to SOEs, whose performance and repayment capacity could potentially destabilise the financial system. The financial position of SOEs is already giving rise to defaults, as illustrated by the number of non-performing loans (NPL)[14] in 2015, which is double the figure posted in 2014[15]. Estimates emerging from Belgian think tank Bruegel[16] indicate that the total volume of non-performing loans amounted to CNY 1.27 trillion at the end of 2015[17] – equivalent to the size of the Spanish economy. These estimates are in line with IMF predictions[18].

Chart 8 Debt-equity ratio in selected sectors



Source:
Business Insider based on companies holding A shares in the sectors mentioned
http://uk.businessinsider.com/china-debt-to-gdp-statistics-2016-1

Under heavy pressure due to the problems caused by overcapacity and debt, as mentioned, in September 2015 the Chinese unveiled government its long-awaited SOE reform plan. On paper at least, and on the basis of the heralded reforms, this is the most ambitious SOE reform plan to date and requires the highest level of commitment from the government. One of the main objectives of the reform programme will be to increase the involvement of the private sector and foreign companies in SOEs. This opens the door for purchases of share packages and convertible bonds. The SOEs most exposed to the entry of private and foreign capital will be those operating in the oil, gas, electricity, railway and telecommunications sectors. The reform document distinguishes between two types of SOEs: "commercial" (shangyelei) and "public interest" (gongyilei). Privatisation will only affect commercial SOEs, with the government retaining ownership of 100% of public interest SOEs for public welfare purposes. Equity swaps between SOEs and private investors will also be possible. The equity swap programme aims to enable CNY 1 trillion of debt to be written off SOE balance sheets. The risk would, however, be transferred to the new debt holder, which somewhat reduces the incentive for private firms to get involved in the programme.

The government will also reduce the number and size of SOEs through a series of mergers and acquisitions involving the different companies, which would also entail an asset restructuring process in many of these companies. The Chinese authorities have already acquired a certain degree of experience in managing mergers of major public entities. In early 2015 came

[13] "SOE reforms could unlock the potential of unproductive sectors and boost growth". BBVA Research. Carlos Casanova, Betty Huang y Le Xia. 2015
[14] Loans that are in default or about to fall into default, i.e. more than 90 days past-due.
[15] See: http://www.reuters.com/article/us-china-banking-npl-idUSKCN0UQ04D20160112
[16] China Banks: the way forward. Alicia García Herrero. Bruegel. 2016.
[17] See: http://www.bloomberg.com/news/articles/2016-04-15/china-may-have-1-3-trillion-of-risky-loans-imf-report-shows
[18] Although official figures indicate an NPL ratio of around 1.8% of the total, based on various private estimates the actual figure could be closer to 12%-15%.

the announcement of the merger between the two largest state-owned railway sector enterprises, China CNR Corporation Limited (CNR) and China South Locomotive & Rolling Stock Corporation Limited (CSR), to produce the new China Railway Rolling Stock Corporation (CRRC), valued at USD 26 billion. Moreover, at the end of 2015 the merger of the shipping companies COSCO and China Shipping Group was approved, giving rise to a new shipping giant, China COSCO Shipping Group. This is the largest shipping conglomerate worldwide by number of vessels and market value; specifically, it has a market value three times greater than that of the Danish firm Maersk[19], which ranks second.

New investment vehicles, the so-called State Capital Management Companies (SCMC), have also been created. These government divisions will be tasked with efficiently allocating state equity and budgets to the SOEs with the greatest growth potential, and which have incorporated technology to highest degree with respect to the environment or strategy. The aim is also to guarantee autonomy in managing these companies and to gradually introduce measures to increase workforce productivity, enabling performance-related salary incentives, for example. Finally, the need to find an outlet for the surplus installed capacity of these large SOEs is one of the main instigators of the large-scale government initiatives presented in the last two years, such as the One Belt, One Road (OBOR) project and the Asian Infrastructure Investment Bank (AIIB), which are analysed in section 4. The table below summarises the SOE reform measures.

6 measures aimed at reforming SOEs

- ✔ Increase the presence of private capital in the shareholder structure
- ✔ Undertake a merger process
- ✔ Start up new investment vehicles (State Capital Management Companies)
- ✔ Guarantee autonomy in their management
- ✔ Increase productivity
- ✔ Find an outlet for surplus capacity through the One Belt, One Road (OBOR) project

[19] See: http://www.wsj.com/articles/china-cosco-shipping-merger-expected-to-kick-off-further-consolidation-in-industry-1454598139

Box 1

Risks of expansion in the Chinese real estate sector

A recurring theme when discussing the challenges facing the new China is the risk of a real estate bubble and its effect on the stability of the economy. Three factors have contributed to the rapid expansion of the real estate sector in China in recent years.

Firstly, there has been mass migration from rural to urban areas, fostered by the government, which has caused the number of homes required in large cities to sky rocket. According to official data, over the last 20 years the percentage of the Chinese population living in urban areas has increased from 30% to 54%, following a mass internal migration of 300 million people. The aim of the government in Beijing is to continue this process and for a further 100 million citizens to migrate to urban areas by 2020. This movement has led to the construction of millions of new homes both in the centre of the urban hubs and in the surrounding areas.

Secondly, the excess liquidity available in the market, particularly since the 2008 fiscal expansion measures were introduced, has prompted thousands of companies to take on construction and real estate activity, generating significant dysfunction in some cases. For example, certain companies built a large number of homes in third and fourth tier cities, drawn in by low land prices, although these investments could not actually be justified by potential demand.

Thirdly, the scant availability of investment options, given the limited access to financial products, coupled with stock market volatility, in a country with one of the highest levels of savings in the world, have tempted large amounts of Chinese savings into real estate investments, causing an upward spiral of rising prices.

By the end of 2015 there was a total of 718 million square metres of unsold homes and commercial premises, which is sufficient space to house around 20 million people. This would indicate that the growth rate of the real estate sector, which accounts for 15% of China's GDP, poses a certain level of risk to the stability of the economy[20]. Besides the direct impact that a collapse in the real estate market would have on the companies operating in this sector and their employees, a sharp decline in prices would also negatively affect the balance sheets of financial institutions. According to certain analyses, an estimated 60% of bank loans are associated with the real estate sector[21] and 30-40% of the collateral pledged as security for bank loans are real estate assets[22]. Also worth noting is the potential impact on the wealth of Chinese households that invest in real estate, which could see a decline in their purchasing power.

In recent years there has been a significant divergence in asset prices. Real estate prices are rising in the country's most prosperous cities, particularly Beijing and Shanghai, which are the areas favoured by young people with substantial purchasing power, and also in Guangzhou, Sanya and Shenzhen. The most notable increase has been seen in Shenzhen, which has become one of the most attractive tech hubs in the country. Prices here rose by 53% on average in 2015[23]. A square metre of floor space in Shanghai costs USD 509, while the cost in Shenzhen is USD 659. Conversely, in third and fourth tier cities no interest has been shown in buying the empty homes either for residential purposes or as investment property, and these are declining in price.

Financial investors that operate in the real estate sector are aware of the lack of demand in these cities and the high risk posed by the purchase of real estate assets in these locations, and have chosen instead to focus on the aforementioned cities, therefore placing greater upward pressure on asset values. Moreover, the proliferation of peer-to-peer (P2P)[24] financing platforms geared toward the real estate market, such as pinfangwang.com.cn, which is based on collective purchases starting at USD 160, reduces the risk inherent in speculative operations and could even contribute to the rise in prices. We must not forget either that the restrictions placed on capital leaving the country following the financial volatility experienced in 2015 and 2016 could pump up the housing market again by limiting investment options.

[20] http://internacional.elpais.com/internacional/2016/02/26/actualidad/1456502478_209415.html

[21] http://www.ft.com/intl/cms/s/2/65a584e2-da53-11e5-98fd-06d75973fe09.html#axzz45bLmgqWo

[22] http://www.ft.com/intl/cms/s/0/385cb206-c358-11e5-b3b1-7b2481276e45.html#axzz45bLmgqWo

[23] See: http://www.economist.com/news/finance-and-economics/21694530-house-prices-are-soaring-big-cities-oversupply-plagues-much

[24] P2P: Direct financing between individuals or without intermediaries

3. The China of the future: initiatives and opportunities

3.1. The new roadmap: 13th Five-Year Plan (2016-2020)

Drafting of the 13th Five-Year Plan (2016-2020) began in 2015, when the 12th Five-Year Plan (2011-2015) was drawing to a close. The bases for the new plan were the consultations and meetings promoted by the National Development and Reform Commission (NDRC), the ultimate authority in terms of the country's reform. The final document was endorsed by the National People's Congress, and implemented in March 2016. The Five-Year Plan is a compendium of proposed initiatives that will dictate the Chinese government's intervention in the economic and business arena over the coming five years, and is a key tool for anticipating and understanding the course of the economic reforms. The ultimate aim of the Five-Year Plan is to achieve a "moderately prosperous society" based on average economic growth of 6.5% from 2016 to 2020, and to double per capita GDP by 2020 compared with 2010. The main features of the 13th Five-Year Plan are analysed below.

The 13th Five-Year Plan is a continuation of the previous plan. That said, while the areas of action are principally the same, the measures are more ambitious and are expected to have a more profound impact. Possibly the most significant change in the 13th Five-Year Plan with respect to its predecessor is the importance placed upon innovation. Express support of certain economic sectors has been replaced by a cross-cutting approach wherein reforms aimed at encouraging innovation in all pockets of the economy are a key component. Two initiatives in this area are particularly noteworthy: Internet Plus and Made in China 2025. Although these two initiatives were brought into play in 2015, they will be especially emphasised over the duration of the new Five-Year Plan.

Internet Plus entails the reduction of internet tariffs coupled with an increase in internet speed, as well as greater integration of big data and the internet of things in the various economic sectors, including traditional industries. To this end, an R&D investment target of 2.5% of GDP has been set for 2025, while households in major cities should have access to an internet speed of 100 megabytes per second, or broadband should reach 98% of the population[25].

Made in China 2025 is a ten-year plan which, in the words of Industry and Information Technology Minister Miao Wei, seeks to achieve industrial capacity equal to that of Germany and Japan at their early stages of industrialisation. The purpose of the plan will be to implement various initiatives aimed at incorporating services and technology into products and manufacturing processes. The sectors to be covered by the strategy are agricultural equipment, electric vehicles, biomedicine and medical apparatus, maritime engineering, communications technologies, aviation and aerospace equipment, electrical power equipment and robotics[26-27].

After innovation, the next priority to be addressed through the Five-Year Plan is that of reducing the negative impact of economic development, and of industrial activity in particular, on the environment. The new measures include the introduction of stricter environmental standards, and incentives for managers of major firms to encourage a decrease in emissions. Moreover, low carbon sectors and electric vehicles are favoured, the creation of a green fund has been announced, and a cap of 5 billion tonnes has been set for energy consumption**28. The Chinese government has also established an additional incentive for the reduction of industrial emissions, having undertaken various commitments in this respect during the Paris Climate Change Conference held in December 2015[29].

[25] "China Internet Plus Strategy". Betty Xu. Seconded European Standardization Expert in China (SESEC) Projects. 2015

[26] See: http://knowledge.ckgsb.edu.cn/2015/05/21/policy-and-law/made-in-china-2025-chinese-manufacturing-to-get-a-makeover/

[27] See: http://www.chinadaily.com.cn/bizchina/2015-05/19/content_20760528. htm

[28] See: http: //españachina.es/blog/xiii-plan-quinquenal-de-china-crecimiento-economico-chino/

[29] See: https://www.chinafile.com/reporting-opinion/environment/how-chinas-13th-five-year-plan-addresses-energy-and-environment

Besides the financial system and SOE reforms already mentioned, the innovation and environmental policy measures laid down in the new Five-Year Plan are likely to have the greatest impact on the Chinese economy in the coming five years. Nonetheless, the Five-Year Plan also includes a number of measures that affect other areas of activity. These are summarised below[30] :

• Strengthening of the antitrust policy, particularly in sectors still subject to a monopoly: electricity, telecommunications, transport, oil, natural gas and public services.

• Tax reform to increase the decision-making capacity of central government and other authorities when allocating resources.

• Greater autonomy for universities and research bases, including management of funds and personnel. Promotion of innovative education practices.

• Reform of the rural system for distributing and protecting farmers' and rural dwellers' agricultural land ownership rights.

• Greater investment by central and provincial governments to reduce the poverty index.

• Extension of social security cover to all Chinese citizens and a reduction in health insurance costs.

• Acceleration of urban development – at the end of this process the aim is for 60% of the Chinese population to be living in cities by 2020 (54% in 2014, according to World Bank data).

• Development of new infrastructure, entailing the implementation of mammoth projects such as extending the high-speed network to 30,000 km so as to serve 80% of major cities, or building 50 new airports.

3.2. Making headway in the financial system reform

The Chinese authorities are aware that the transition towards sustainable growth requires a reform of the financial system. This section analyses three key aspects of the Chinese financial system that have undergone reform in the last three years: liberalisation of the capital account, which aims to facilitate capital flows inside and outside Chinese borders; bringing bank interest rates into line with market value; and relaxation of the criteria currently used to determine the value of the yuan.

Liberalisation of the Chinese capital account. In terms of capital account liberalisation, China continues to be one of most restrictive economies in the world. According to the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), restrictions on capital inflows remained in force in 14 of the 15 categories, and 15 of the 16 categories in the case of capital outflows[31]. Foreign investments require government authorisation[32] and the operations of authorised investors continue to be subject to quotas and timing restrictions.

In recent years considerable progress has been made towards facilitating liberalisation of the capital account. Various steps have had a positive impact on the Chinese economy and are indicative of the government's intention to head towards greater liberalisation of the country's capital account, so as to increase the involvement of foreign players in local capital markets and for Chinese citizens and enterprises to have more options for transacting abroad. It has been announced that QFII and RQFII will be able to undertake unrestricted operations in the market for bonds. This easing seeks to increase the involvement of foreign investors, particularly those of an institutional nature, which make up only 2% of the total at present. Furthermore, a number of pilot projects have been devised in certain Chinese cities to lift restrictions and enable citizens to access more than USD 50,000, the current ceiling, with which to undertake their transactions abroad[33]. Meanwhile, investment quotas have been raised through the Shanghai-Hong Kong Stock Connect programme, which will enable investors from continental China to access the Hong Kong securities market and foreign investors to access shares in the Shanghai market with fewer restrictions.

[30] Information based on the publications of the Chinese government representative at the United Nations at the end of 2015

[31] "Annual Report on Exchange Arrangements and Exchange Restrictions". IMF. 2014

[32] Only Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) are entitled to undertake foreign transactions, and only Qualified Domestic Institutional Investors (QDII) may conduct domestic transactions.

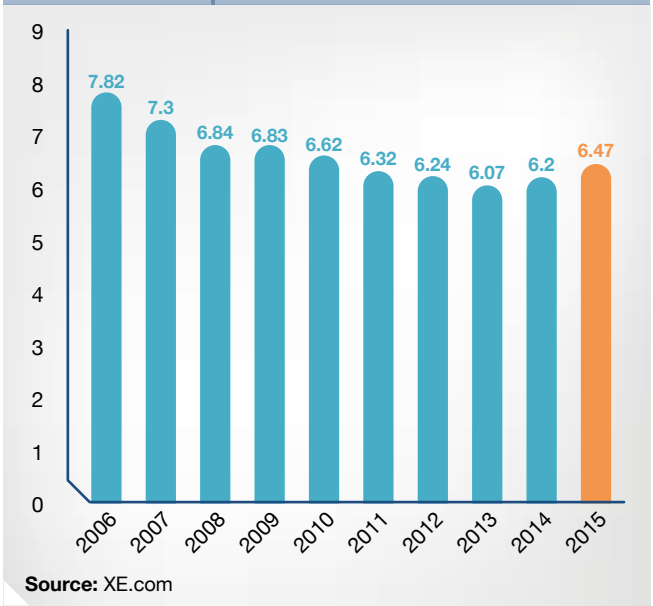
[33] See: http://ftalphaville.ft.com/2015/07/17/2134607/this-isnt-the-chinese-capital-account-liberalisation-youre-looking-for/

Bringing bank interest rates into line with market value. In the last three years we have witnessed a de jure liberalisation of bank interest rates on both loans and deposits. In July 2013, just four months after Xi Jingping took up his position as President of China, interest rates on bank loans were liberalised; until then, rates were subject to a floor of 70% in the benchmarking and 6% imposed by the government. Later, in 2015, the deposit interest rate was removed. This liberalisation benefits families and enterprises alike, in terms of greater competition in the banking sector which forces banks to offer savings and investment products at more attractive rates. Moreover, economic agents have reduced the cost of accessing credit, which should have a positive impact on consumer spending and business activity. There are also expectations that interest rate liberalisation will lead to a more efficient allocation of resources and greater market discipline in channelling credit, as banks will apply different interest rates depending on the customer's risk rating. In any case, although financial institutions already have the freedom to set their own interest rates for deposits and loans, other de facto barriers are still in place, which mean that total interest rate liberalisation is not yet a reality. By way of example, the benchmark interest rates applied to SOEs – which, as indicated previously, are the principal recipients of private credit – are still in place. The interest charged on loans to SOEs, in view of the considerable proportion of total credit they represent, is the basis for determining the prices at which financial institutions are permitted to lend to other economic agents. As such, although interest rate deregulation has come along in leaps and bounds in recent years, there is still room for improvement in terms of total interest rate liberalisation.

Relaxation of the criteria used to determine the value of the yuan. As regards the value of the yuan, since the mid-90s the Chinese currency has been strongly indexed to the US dollar, although the government has been taking steps to introduce market criteria in determining the local currency exchange rate. Specifically, since 2005 the fluctuation band has been progressively widened (the latest being +/- 2% in 2014), and the Chinese currency has appreciated 35% vis-à-vis the dollar since then. However, over the last two years the value of the yuan has slid down again due to two episodes of financial instability, as reflected in chart 9.

In August 2015, in response to an IMF request for the yuan to reflect a valuation more commensurate with its market value with a view to its inclusion in the Special Drawing Rights (SDR)[34], the reformist governor of the Central Bank, Zhou Xiaochuan, decided to implement a 1.9% reduction in the exchange rate, which he announced as an extraordinary movement. A further depreciation was nevertheless approved, and effected a day later, leading to a 4.8% drop in the currency's value in the Hong Kong yuan market. Even so, the government is not expected to back a continuous decline in value of the yuan vis-à-vis the dollar, since this would hinder repayment of China's current CNY 1 trillion debt, would reduce private consumer spending capacity in mid-transition of the economic model, and would complicate the implementation of the One Belt, One Road (OBOR) initiative, making transaction financing more expensive[35]. However, the lack of clear communication from the Central Bank, combined with the slow-down and growing public debt, as well as doubts concerning the reliability of certain economic data, enticed a huge USD 1 trillion abroad in 2015 alone according to Bloomberg data, which is equal to the size of the Turkish economy.

Chart 9 USD - yuan exchange rate (2006-2015)



Source: XE.com

[34] The SDR is the IMF's benchmark currency and consists of the US dollar, the euro, the pound sterling, the yen and, since 2015, the yuan. For more information on the implications of including the yuan in the currency basket, see Box 2 of this report.

[35] See: http://www.economist.com/news/finance-and-economics/21688440-chinas-leaders-face-menu-unappealing-exchange-rate-options-fight-or-flight

As a result of financial turbulence and the increase in short positions on the yuan, between 10 and 27 August 2015 the share prices of companies listed on the two Chinese stock markets fell by 21.5% on average. This collapse in the stock market was an abrupt correction to a market that had grown hugely. In the case of Shanghai (Shanghai Composite Index or SCI), growth from June 2014 to June 2015 was 150% (see chart 10).

A second wave of volatility was to come in January 2016, triggering an average decline of 16.4% in share prices. In this case, the Chinese government decided to intervene in the capital markets, managing to curb the volatility by prohibiting SOEs from selling more than 5% of their portfolio, suspending several IPOs, and pressurising public bodies to increase their long positions.

Without a doubt, reforming the Chinese financial system is an immensely complex task that entails a large number of initiatives, wherein each solution carries its own risk, bringing further complexity to the reform process. The main initiatives can be summarised as follows:

• Bringing bank interest rates into line with market value, without jeopardising the volume of credit, but also without encouraging the advent of asset bubbles.

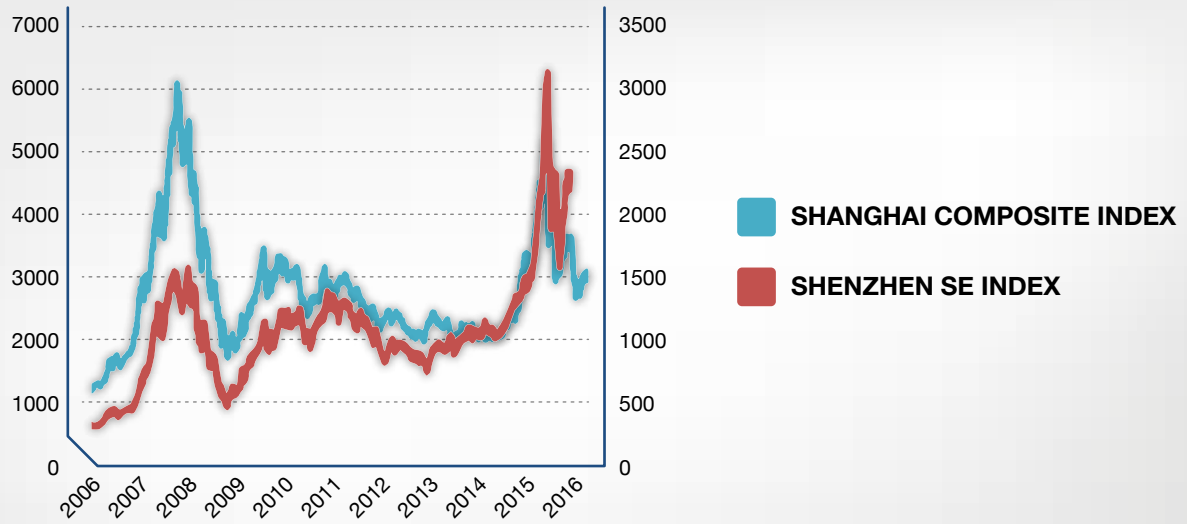
• Opening up the capital account to foster access to greater foreign resources, but without prompting an abrupt entry of hot money[36].

• Widening the yuan fluctuation band so that it gradually gets nearer its market value, while controlling expectations as to its future value.

• Examining and increasing the number of companies listed on stock exchanges, but bringing share prices more into line with the companies' book value so as to reduce speculative transactions.

All of these reforms require clear rules and transparent data, as well as credibility and a correct communications policy on the part of the Central Bank. The reform of the financial system is therefore expected to take a few years to complete and could bring on new episodes of volatility in the financial markets, which would in any case be short-lived, similar to those seen in 2015 and 2016.

Chart 10 Performance of Shanghai Composite Index and Shenzhen Stock Market Index (2006 - Q1 2016)



Source: Yahoo Finance.

[36] Speculative capital that quickly enters and exists a country to take advantage of exchange rate volatility.

Box 2

Internationalisation of the yuan

Author: Adrián Blanco, Economist

Despite the Asian giant having climbed the ranks in recent years to become the second largest economy in the world, its currency continues to play a secondary role with respect to its use at international level, and is far behind the currencies with which it should be competing in view of China's economic prowess, i.e. the US dollar, the euro and the yen. The yuan currently accounts for just 1% of the world's total reserves. It is the eighth most used currency in the world for the issue of bonds and ranks ninth in foreign exchange transactions[37].

China is currently the world's leading goods trader and its public banks are fundamental players in the financing of projects in developing countries. Both of these facts should have served to increase the yuan's presence at international level. However, economic agents and business owners are somewhat sceptical regarding the widespread adoption of the yuan in these types of operations. In 2015 commercial transactions performed in yuan amounted to USD 1.7 trillion, which is one quarter of the total volume of trade in China[38] .

In recent years, Beijing has attempted to promote greater use of its currency through various initiatives. Since 2004, aware of the limits of the Chinese financial system, the government in Beijing has been promoting an offshore market for the use of the yuan in Hong Kong, with the recent addition of cities such as London, Paris and Frankfurt. They have authorised businesses to open an account in yuan in these markets and to issue corporate bonds in the currency (the so-called dim sum bonds). What's more, in recent years companies in China have been authorised to use the yuan in their commercial dealings abroad; this had been a restricted practice until now.

The RMB Qualified Foreign Institutional Investor programme has also been launched, which allows qualified foreign operators, subject to approval and numerous restrictions, to invest in both the stock and bond markets. The currency swaps between central banks are also worth noting, increasing the use of the yuan as a reserve currency in up to 70 countries, although its relative weight continues to be symbolic.

One important step in extending the use of the yuan and in the international recognition of the currency was its inclusion in the IMF's SDRs (special drawing rights) at the end of 2015. The IMF confirmed that China's currency "meets the current criteria for inclusion", may be used freely and is fully convertible. As a result, despite the tight capital controls that continue to exist in China, the yuan became part of the basket of currencies that make up the SDRs, together with the US dollar, the euro, the pound sterling and the Japanese yen[39], representing 10.9% of the total, as can been seen in table 1.[40]

Table 1

Composition of IMF Special Drawing Rights (% of total)

	2001	2016
US DOLLAR	45	41.7
EURO	29	30.9
YEN	15	8.3
POUND STERLING	11	8.1
YUAN		10.9
TOTAL	100	100

Source: FMI [41]

Over the coming years, the yuan is expected to gradually be used in a larger number of transactions and international operations. The currency has various points in its favour, such as its established commercial strength and the OBOR project, which should act as a channel for greater international use of the yuan to finance large-scale projects[42]. Conversely, the episodes of financial volatility seen in the past two years and the difficulties expected to arise when reforming the financial system, including interest rates, could disincentivise the use of the yuan at international level in the coming years.

[37] See: http://economia.elpais.com/economia/2016/01/06/actualidad/1452102709_541259.html

[38] "China's efforts to expand the international use of the renminbi". Eswar Prasad. 2016

[39] SDRs are international reserve assets created in the 1960s by the IMF to supplement central bank reserves. They are currently used by the 188 member countries of the IMF in numerous transactions and operations. At international level, they are primarily used in operations involving the IMF itself or as a reserve currency, accounting for 3% of global reserves, which is far behind the US dollar .

[40] See: https://www.imf.org/external/np/exr/facts/sdrcb.htm

[41] See: https://www.goldmoney.com/research/goldmoney-insights/the-imfs-special-drawing-rights-the-rmb-and-gold

[42] In any case, note that the recently formed AIIB has indicated that it will perform all its transactions in US dollars.

3.3. Large-scale initiatives for the coming decades: One Belt, One Road and new multilateral banks

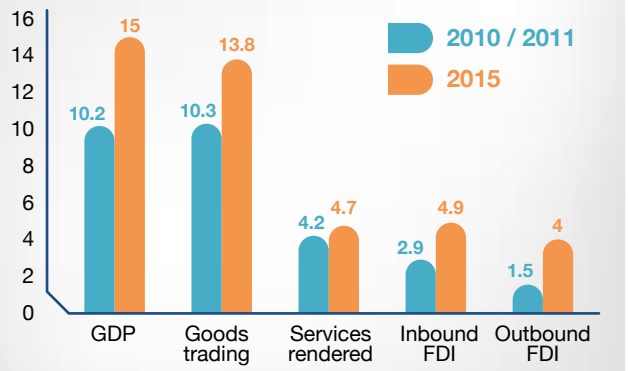
The slow-down in the economy and the uncertainty associated with the transformation of the Chinese economic model should not be read as a scaling down of Asia's role as the leading emerging economy for the 21st century. Even though the prolonged expansive period that saw GDP growth rates in excess of 10% has drawn to a close and China has embarked upon a new phase of more modest growth, its relevance as a global economic power has not been knocked. Quite the contrary. China has continued to climb the global economic leadership ladder in terms of its relative weight as per worldwide financial indicators, progressing from a 10.2% share of the global economy in 2011, the year when things started to cool down, to 15% in 2015. Moreover, while the worldwide economy has declined in recent years, China's share of the global market for merchandise has risen from 10.3% to 13.8%.

Neither does the perception that foreign multinationals have of China appear to have been damaged – its share of global inbound FDI rose from 2.9% in 2010 to 4.9% in 2015, as reflected in chart 11. Chinese firms also continued to expand their footing worldwide, with China's cumulative foreign investments growing from 1.5% in 2010 to 4% in 2015[43]. Based on UNCTAD data, China's inbound investments in 2015 (USD 135.61 billion) still surpassed its outbound investments (USD 127.5billion), although the gap between the two figures is closing. If China continues along this path it will foreseeably become a net exporter of FDI in the coming years. Albeit in the absence of consolidated data, China's financial role in certain regions would appear to indicate that the volume of loans to other countries has increased. For example, loans to Latin America amounted to USD 29 billion, which is more than in the two previous years combined. Furthermore, China continued to concentrate between 50% and 60% of worldwide output of steel, nickel, coal and aluminium, while also producing a substantial volume of copper, zinc, iron, cotton and soybeans.

In recent years, Chinese FDI worldwide has grown exponentially; in just ten years, it has climbed from less than USD 20 billion to more than USD 100 billion as of 2013. In 2015, the most recent year for which confirmed data are available, China's global investments hit a new record of USD 127.5 billion, making this country the world's third largest investor (see chart 12).

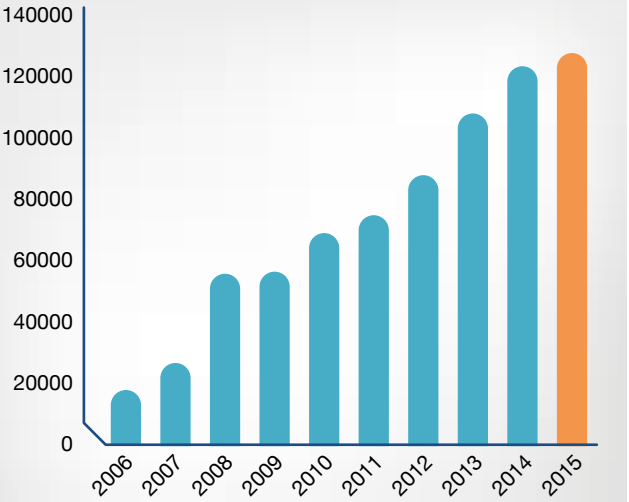
The Asian country's international strategy took a qualitative leap in 2015 and 2016 with the start-up of various large-scale projects and initiatives that should serve as the foundation and base-line strategy for the country to achieve a greater global economic and business presence in the coming decades, which should in turn impact even more positively on volumes of FDI. The two main initiatives that will define China's intervention on the worldwide stage in the coming decades are analysed below. These are the One Belt, One Road (OBOR) project, also known as the New Silk Road; and the start-up of the multilateral financial institutions – the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), also known as the BRICs Bank.

Chart 11 Relative global weight of the Chinese economy as per selected variables (2010/2011-2015)



Source: Own research based on UNCTAD and IMF data [44]

Chart 12 Chinese outbound FDI (2006-2015)



Source: Own research based on MOFCOM data

[43] Chinese FDI stock relative to total FDI stock total as per UNCTAD data for 2010 and 2015

[44] In order to use the most up-to-date official data, 2011 and 2015 data have been taken for GDP and trade, whereas for inbound and outbound FDI, 2010 and 2015 figures have been used.

One Belt, One Road (OBOR) – The first steps

The OBOR project, also known as the "New Silk Road", is a cornerstone of Beijing's foreign political and economic strategy for the coming years. No other initiative better reflects the extent of China's aspiration to become a global economic and business leader in the first half of the 21st century. As is common knowledge, this initiative is a compendium of infrastructure mega-projects that aim to establish two major trading corridors, one land-based (One Belt) and the other ocean-going (One Road), picking up much of the network of trade routes that operated between China and Europe in the 15th century (the Silk Road)[45]. The project was first announced by China's President, Xi Jingping, at the end of 2013 and has been extensively covered by specialised media the world over, understandably generating huge expectation, given the scale of the initiative.

The projects will extend to 60 countries that concentrate 70% of the worldwide population, 55% of GDP and 75% of known energy reserves. At USD 4 trillion, the budget will be several times higher, at present value, than that allocated to the Marshall Plan, the US aid programme to rebuild Europe following the Second World War. One of the programme's components alone, the construction of railway lines, will entail the entry into service of 81,000 km of track, which is more than double the total current worldwide network[46]. Furthermore, this being a 35-year plan, it will draw to a close in 2049. This is a symbolic year for the Asian country, marking the centenary of the foundation of the People's Republic of China.
Five main factors have driven and shaped the initiative, and justify the Chinese government's implementation of such a monumental plan. These are analysed below.

• Firstly, the economic factor. The government needs to back measures that provide an outlet for the surplus installed capacity in China's industrial sectors, principally affecting SOEs, as mentioned previously. In this respect, Chinese SOEs would be required to participate in at least those projects financed by the China Development Bank (CDB) and the Export-Import Bank of China (EXIM Bank), through works and supply contracts.

• Secondly, the financial factor. Beijing's intention continues to be that of promoting international usage of the yuan, which is still a little-used currency, even though it is backed by the second largest economy in the world. The magnitude and scope of OBOR should increase the international use of the Chinese currency in the financed projects, leading it to compete with the dollar as the currency used in certain emerging countries[47].

• Thirdly, the commercial factor. The proliferation of new infrastructure and logistics corridors should bring about a reduction in operating costs of foreign trade transactions, which should in turn increase the volume of such transactions. Until now, imports of oil and commodities from the Middle East arrived via the China Seas, but the land corridors through Pakistan will make journeys 90% shorter for commercial transactions. According to Chinese government estimates, by 2025 China's trade with the countries included in the initiative will amount to USD 2.5 trillion[48]. Beijing has also stated that the initiative will serve to drive trade agreements, reduce customs duties and simplify administrative procedures for foreign trade transactions.

• Fourthly, the geostrategic factor. The Beijing government aims to extend its regional power and diplomatic mechanism under the OBOR initiative, increasing its footing in a number of countries, particularly the former Soviet republics and Eastern Europe thus far, as well as various Muslim countries. Notably, in 2015 Beijing approved its first anti-terrorism law, enabling China to deploy troops outside home territory in the event of a national security threat.

• Fifth is the energy factor. The Asian nation is the primary consumer of energy in the world, and the main net importer. Its needs have ballooned by 500% since the liberalisation process began in 1980, and security of energy supply is a pivotal factor for Beijing.

The projects encompassed by the initiative will be financed by the recently created multilateral banks, the Asian Infrastructure Investment Bank and the New Development Bank (see next section), as well as China's major state-owned banks. In the case of the latter, the Bank of China has committed to provide USD 100 billion and the CITIC Bank a further USD 113 billion. The China Development Bank, China's principal lender to foreign recipients, will finance 900 projects, providing an estimated USD 890 billion. The EXIM Bank is also expected to be actively involved[49]. At the end of December 2014, the government set up an investment vehicle – the so-called Silk Road Fund – with a pool of USD 40 billion to finance those projects. The fund was set up with resources provided by the People's Bank of China (Central Bank), the China Investment Corporation (the country's main sovereign wealth fund), as well as the China Development Bank and the EXIM Bank, as mentioned. In addition to the Chinese financial institutions, other multilateral banks and state-owned and private banks from other countries could be brought in to co-finance the projects that make up OBOR. In fact, the World Bank could co-finance 12 OBOR projects alongside the AIIB in 2016, according to the Financial Times[50].

[45] Specifically, the initiative will finance projects to develop six corridors: New Eurasian Land Bridge (which will extend to Russia and, subsequently, Europe), China-Mongolia-Russia, China-Central and West Asia, China-Indochina, China-Pakistan and China-India-Myanmar.

[46] Data taken from the Peterson Institute report

[47] http://www.ft.com/intl/cms/s/2/6f105c2a-7f02-11e5-98fb-5a6d4728f74e. html#slide0

[48] "China's Belt and Road Initiative: Motives, Scope and Challenges". Simeon Djankov and Sean Minner. Peterson Institute for International Economics

[49] See: http://thediplomat.com/2015/12/chinas-one-belt-one-road-initiative-outlook-for-obor-and-the-us-rebalance/

[50] See: http://cbw.ge/world/chinas-aiib-seeks-pave-new-silk-road-first-projects/

As is standard practice for Chinese state-owned banks in developing countries, as regards infrastructure financing, the transactions could be contingent upon the works being executed by Chinese firms, which would also supply the required materials. Meanwhile, foreign companies could form a consortium with Chinese enterprises to carry out the projects, or could go solo in cases where they have a clear competitive advantage and notable specialisation.

What projects are underway to date? OBOR has been running for at least two years and the first projects announced under this initiative were carried out in Central Asia in March 2014, following the visit of China's Premier, Li Kequiang, to Kazakhstan. A year later, the two countries announced China's largest foreign investment project to date: the China-Pakistan Economic Corridor, an infrastructure development package, including telecommunications, valued at USD 46 billion. Not only are Pakistan (with 182 million inhabitants) and Iran (with 77 million)[51] promising trading partners of China; they are also key suppliers of energy, as well as being a natural land bridge to Europe[52]. Their participation in OBOR is therefore critical.

China has continued to make a number of investments in the countries where the OBOR project is being rolled out, and not only in infrastructure. These investments have now reached USD 14.8 billion in 49 countries, while tenders totalling USD 92.6 billion have been awarded.

New financial institutions: Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB)

The creation of a new multilateral bank backed by China – the AIIB – is one of the most relevant initiatives for decades in the field of International Financial Institutions (IFIs). The recently created financial institution has a dual purpose. On the one hand, it aims to drive infrastructure development in Asia, which needs an injection of USD 750 billion to catch up with developed countries[53], facilitating the financing of major infrastructure projects. On the other hand, and from a wider perspective, the AIIB aims to address the multilateral institutions' inability to afford a greater relative weight to emerging countries, China in particular. The Asian nation, which ranks first in the world in terms of population and second by relative economic weight, was not seeing its importance reflected in the executive bodies of institutions such as the IMF, and had expressed its discontent with the modest relevance accorded by the World Bank to the region's infrastructure[54]. For example, with respect to voting power, as illustrated by table 2, the United States control 16.6% of the IMF, while China, the world's second largest economy, holds only 6.14%.

As regards impact, the AIIB is expected to become one of the financial institutions most capable of financing infrastructure worldwide. It has an initial capital of USD 100 billion, which is equivalent to two thirds of the other major Asian multilateral bank, the ADB, less than half of the World Bank and one third of the European Investment Bank (EIB). According to its articles of association, the AIIB could have leverage of 2.5 times its subscribed capital, representing maximum financing of USD 250 billion. As reflected in chart 13, its initial capital falls short of other multilateral banks such as the World Bank and the European Investment Bank. As for the financing of activities, which for this type of institution is usually through the markets, it remains to be seen whether the AIIB will be able to access wholesale financing under terms that grant the maximum credit rating to other multilateral institutions. Conversely, it will receive financial contributions from the major state-owned Chinese banks, which are currently the world's main financers of developing countries, and which could channel a portion of their transactions through the AIIB.

Table 2

IMF voting power relative to global GDP

	IMF voting power (%)	Global GDP (%)
CHINA	6.14	15.01
INDIA	2.66	2.86
RUSSIA	2.61	1.81
BRAZIL	2.24	2.42
SOUTH AFRICA	0.64	0.42
SUBTOTAL EMERGING ECONOMIES	14.29	22.52
UNITED STATES	16.6	24.52
UNITED KINGDOM	4.07	3.89
GERMANY	5.37	4.59
FRANCE	4.07	3.31
ITALY	3.05	2.48
SPAIN	1.94	1.34

Source: FMI

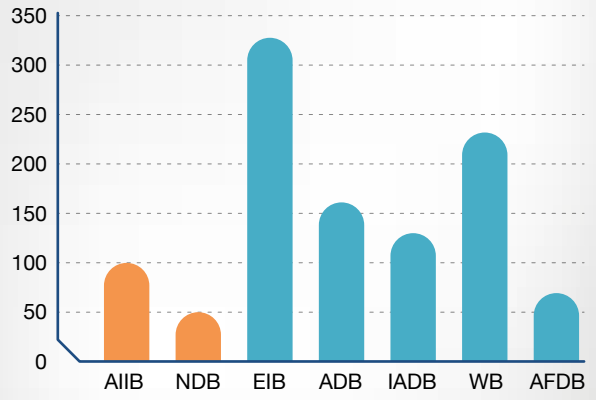
[51] The Asian nation is the world's number one importer of oil, its two main suppliers being Iran and Saudi Arabia, the region's two great rivals. President Xi Jingping was the first head of state to visit Iran after the sanctions were lifted in January 2016, when he proposed the construction of a 3,200 km railway corridor to connect Tehran with the Chinese city of Urumqi, a project to be executed by the China Railway Corporation.

[52] Although the land bridge to Europe will pass through the Caucasian corridor, it is expected to subsequently link Iran with Turkey so as to cover the Mediterranean sea route to Europe.

[53] Infrastructure for a Seamless Asia. Asian Development Bank Institute 2009.

[54] China's rise as a regional and global power: The AIIB and the 'one belt, one road'. David Dollar. Brookings Institution. 2015.

Chart 13 | Capital subscribed by multilateral institutions



Source: "The Asian Infrastructure Investment Bank. A New Multilateral Financial Institution or a Vehicle of China's Geostrategic Goals". EPSC (European Political Strategy Centre). European Commission. 2015; AIIB: Asian Infrastructure Investment Bank; NDB: New Development Bank; EIB: European Investment Bank; ADB: Asian Development Bank; IADB: Inter-American Development Bank; WB: World Bank; AFDB: African Development Bank. Figures in billions of US dollars.

Initially, 57 countries have adhered to the initiative as founding members, including major European countries such as the United Kingdom, Germany, France, Italy and Spain[55]. Despite the large number of countries that have been involved in the AIIB from the outset, the new bank seems to have been tailor-made for the Asian nation, the initiative's main instigator. At 29.78%, its voting power by far exceeds that of the countries next in line, namely India (8.36%) and Russia (6.53%), and that of European countries such as Germany (4.48%), France (3.37%), Italy (2.57%) and Spain (1.76%)[56]. China is also the only country with veto power, for which the AIIB's articles of association stipulate more than 25% of votes, rather than the 15% required in other multilateral organisations. The bank's President, elected for a five-year term – which will be pivotal for the bank's strategy and positioning – is Mr. Jin Liqun, formerly of China Investment Corporation (CIC), the Chinese sovereign wealth fund.

The other major multilateral bank started up recently, in which China is a key stakeholder, is the New Development Bank (NDB, better known as the BRICs Bank). This initiative was instigated by India following the 4th BRICs Summit held in New Delhi in 2012. In general terms, the NDB could be said to share the two primary objectives of the AIIB: to support the financing of major infrastructure projects, and to make headway towards a new institutional architecture wherein emerging countries play a more prominent role. There are nonetheless some substantial differences. The projects financed will focus less on infrastructure; and while the target region for the projects will be Asia, they will also encompass Latin America and Africa. On an operational level, rather than distributing voting power on the basis of stakes held, voting rights will be allocated in equal proportions of 20% to each founding member, with no veto power envisaged.

The five founding countries are Brazil, Russia, India, China and South Africa, and these nations' Ministers of Finance will make up the entity's Board of Governors, the bank's chief executive body. The institution will have its headquarters in Shanghai and the first President will be K. V. Kamath from India (formerly Chairman of the technology firm Infosys). The initial capital, subscribed by the bank, is USD 50 billion, although a target volume of USD 100 billion (of which China would contribute USD 41 billion) has been announced, which the countries will bring forward in the coming years. The bank became fully operational in the first quarter of 2016. Its first transaction was approved in April: four renewable energy development loans amounting to USD 81 million in China, USD 300 million in Brazil, USD 250 million in India and USD 180 million in South Africa[57].

Determining how the two new institutions will slot into the international financial system and their relationship with other multilateral institutions is currently at the initial stages. Thus far, acceptance of the initiative by other multilateral bodies has been positive, as indicated by comments from heads of state, who highlight the opportunities generated by project co-financing. Moreover, in 2016 the NDB has already signed several cooperation agreements with the Latin American multilateral bank, Corporación Andina de Fomento (CAF)[58]. In the medium term, major emerging economies are expected to increasingly favour the recently created institutions, to the detriment of the old institutions, not only for their economic and business targets, but also in terms of foreign policy.

[55] Asian countries have welcomed the initiative with huge enthusiasm, convinced that it opens the door for greater regional integration through enhanced connectivity. European countries, meanwhile, have joined the programme in the hope that it will enable their enterprises to be involved in executing the projects. The United States, Canada and Japan have not adhered to the initiative.

[56] "Un nuevo banco multilateral para relanzar la inversión en infraestructuras en Asia" ("A new multilateral bank to relaunch infrastructure investment in Asia"). Jorge Dajani. Real Instituto Elcano. 2015.

[57] See: https://www.rt.com/business/339797-ndb-first-project-loans/#. VxHb-b8a0IQ. twitter

[58] See: http://www.americaeconomia.com/economia-mercados/finanzas/sabia-que-caf-y-el-new-development-bank-sellaron-una-alianza-estrategica

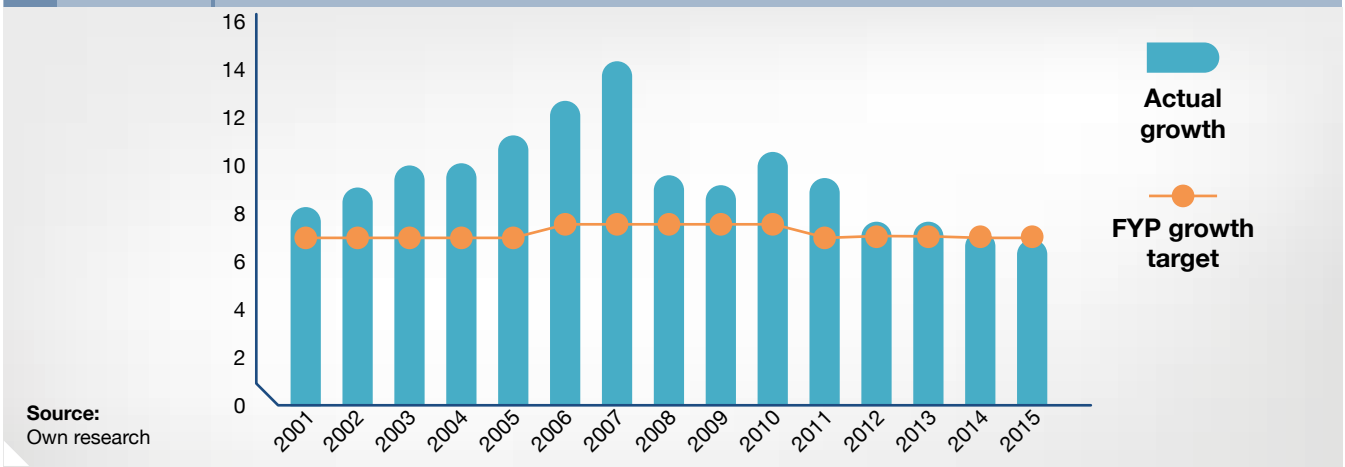
4. Outlook for the future

There are two starkly contrasting views regarding the outlook for the Chinese economy in the coming years; those who foresee a soft landing and those who believe the economy will suffer a sharper decline (hard landing). Those adopting the more optimistic view include the Chinese government and international organisations, which predict annual growth of 6.5% while China transitions towards an economic model with greater emphasis on private consumer spending and services, in which the market will gain ground in the economic and business spheres. They believe that excess debt levels, production overcapacity, the overheating of the real estate market or the reform of the financial system will not lead to a destabilisation of the country's economy. In fact, they consider that even in the event of a major economic downturn, the government has ample room for manoeuvre to offset the decline in activity and, if necessary, absorb the losses derived from the closure of major public sector companies.

However, other commentators, largely international observers and private analysts, including professors Michael Pettis and Christopher Balding of Guanghua School of Management and Peking University, respectively, or the financial magnate George Soros, consider that the imbalances, particularly those related to overcapacity and public debt, could cause China's growth rate to drop to below current levels, even falling into a prolonged period of slow "Japanese style" growth. Furthermore, even assuming that growth is sustainable, they have questioned whether the change in economic model is possible due to insufficient velocity, i.e. at the 6.5% rate targeted in the XIII FYP, growth in consumption would represent just 53.1% of GDP in 2023, which is barely three points higher than its current contribution[59].

The official data published on economic growth for the first and second quarters of 2016, which came in at 6.7%, has reinforced the position of both sides of the debate. Those who foresee a soft landing envisage higher growth than that estimated by the market. Even the IMF upgraded its outlook for growth in China by two-tenths of a percentage point at its Spring Meeting. Conversely, the sceptics maintain that first-quarter growth is owed primarily to the fiscal stimulus, which is reflected both in the growth of M2[60] money supply and the record levels of bank lending seen in January (credit extended in the first quarter came to USD 712 billion, reminiscent of 2009 levels)[61]. The use of debt to boost the economy in 2016, together with the aforementioned spending plans, have heightened scepticism regarding the Chinese economy's true capacity for growth once stimulus is cut back, and the intentions of the government to implement reforms, especially those aimed at loosening controls and reducing debt levels. Notably, in March 2016 the Chinese government presented a plan to raise its budget deficit to 3% of GDP, which is the highest deficit target since 1979.[62]

Chart 14 Chinese GDP growth (%) compared with Five-Year Plans (FYP)



Source:
Own research

[59] See: http://blog.mpettis.com/2015/11/chinas-rebalancing-timetable/

[60] Sum of cash held by the public, demand deposits and assets available for use in transfers. It is normally used as an indicator of the money stock of an economy.

[61] See: http://www.bloomberg.com/news/articles/2016-04-20/china-s-economic-recovery-masking-financial-risks-fitch-says?platform=hootsuite

[62] "Do not bet on fiscal stimulus". The Economist. 2016.

Our perspective: soft landing and reliance on reform plans

With respect to this interesting debate that has polarised a large portion of the economic and business world, ESADE China Europe believes that the Chinese government's reform project will bring about the sustained growth required to change the economic model. Although there are undoubtedly risks, mostly associated with reforming the country's institutions, we are nonetheless more inclined to share the view of soft landing advocates as opposed to the more pessimistic stances.

Firstly, China has always met the economic growth targets established in its Five-Year Plans (see chart 14) and the government has an ample buffer for taking on additional debt due to its low level of public debt. Secondly, we should not underestimate the positive impact that the structural improvements currently underway, such as the liberalisation of the financial sector, the strong focus on public and private innovation or the development of new economic sectors, are having on the Chinese economy's potential for growth. However, in our opinion, the structural reforms are the key issue that will determine the level of risk and, if achieved, will facilitate the change in the economic model and favour the current growth trend.

Thirdly, regarding the impact of debt levels and overcapacity on the Chinese economy, it is unbelievably difficult to predict the level of spending that the central government will maintain in order to stimulate the economy in the medium term and what level of debt could be considered unsustainable. In any case, as consumer spending becomes a bigger driver of growth in the coming years, the government will be able to lessen its reliance on public investment, thereby reducing debt levels.

Lastly, the government is clearly determined to undertake reforms, as demonstrated by the steps taken until now, which bode well as regards its capacity to carry out the remaining reforms. Looking back, it is worth remembering that major reforms were undertaken in the 80s, which despite being considered highly successful, were at the time met with great scepticism and internal opposition. What's more, certain reforms foreseen for the near future are already quite far along so a degree of inertia accompanies the reformist momentum building up in the government, while the various pilot schemes underway have brought experience in handling reforms. For example, in the last three decades 83 SOEs have been absorbed by other public entities in merger processes, with the aim of generating synergies and reducing their size, thereby increasing productivity.

However, the Chinese government will face serious obstacles in undertaking the reform process, particularly in the form of internal opposition to the reduction in size and capacity of industrial SOEs. The senior executives and directors of these public companies, particularly the least competitive entities with the greatest industrial overcapacity, will put pressure on Beijing to limit the effect of reforms that go against their interests. In addition, the curtailment of overcapacity could lead to between 5 and 6 million redundancies, which might cause sizeable groups of the population to lose confidence in the new economic model. In order to mitigate this problem, the government has announced that it will pay indemnities of up to USD 23 billion over the coming two to three years[63]. Nevertheless, in 2015 various protests were already staged against the government's plans, such as those at the Longmay coal mine in the province of Heilongjiang in the north east of the country,[64] and in the same year there were 2,700 strikes in the country, which is twice as many as in 2014[65]. The social effects of the reform will undoubtedly be one of the great challenges facing a country that, due to its size and rapid change, continues to be characterised by sizeable gaps in wealth distribution by geographical area and social class.

[63] See: http://ftalphaville.ft.com/2016/03/02/2154910/layoffs-redistribution-and-chinese-tail-risks/

[64] See: http://internacional.elpais.com/internacional/2016/03/16/actualidad/1458145110_491866.html

[65] See: http://www.economist.com/news/china/21695091-large-protests-miners-augur-ill-governments-reform-plans-deep-pit

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PART II

Chinese investment in Europe: China casts its eye on Southern Europe

PART II

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Charts and tables

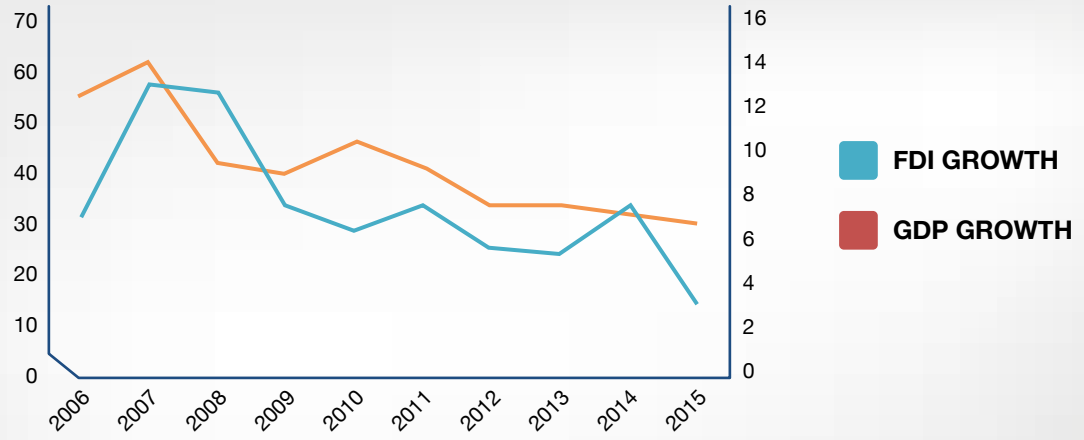
1. 1. Record Chinese investment around the globe in a slowing economy

It has been 35 years since it first began to open up its economy to the outside world and 15 years since the launch of its "Go Out policy", and China has now established itself as one of the world's leading investors. The signs that China would emerge as an economic powerhouse of the 21st century could be seen in the 90s and 2000s, when it became the world's foremost goods trader and the second largest economy on the planet. The Asian giant has also displayed an enormous capacity to finance large infrastructure projects in Africa and to carry out mass purchases of US treasury bonds. In recent years, China has also become a worldwide leader in terms of foreign investment, with Chinese companies investing abroad at triple the average global rate for the past decade. China's FDI continues to reach new highs every year. In 2015, the last full year for which data are available, a new record was achieved: USD 127.56 billion, which is 3.6% higher than the 2014 figure[1]. After becoming a net capital exporter for the first time in its history in 2014, in 2015 China surpassed Germany as the world's leading capital exporter.

The investment capacity and financial muscle of Chinese companies is evidenced by the size of their foreign investments: in 2015 they carried out over 35 operations with a value exceeding USD 1 billion in different economic sectors. The most notable examples are the acquisition of the tyre manufacturer Pirelli by China National Chemical Corporation (ChemChina) for almost USD 9 billion, the acquisition by China Three Gorges of two large hydroelectric plants in Brazil (Jupia and Ilha Solteria) for a total of almost USD 3 billion, the USD 3 billion investment by the Sany Group in the development of 2GW of wind power assets in India and the USD 1.8 billion investment by the private group Fosun in the US insurance company Ironshore. In 2015 Chinese companies carried out over 1,000 foreign investment operations, ranging from office blocks and industrial SMEs to software companies, maritime ports and football clubs. The data available for 2016 when the contents of this report were finalised point towards China setting a new record for foreign investment. According to MOFCOM, between January and April China invested USD 60.08 billion (CNY 391.45 billion), which is a year-on-year increase of 71.8%[2].

As can be seen in chart 1, growth in global Chinese investment follows the same trend as GDP growth. The declining rate of growth in foreign investment should be seen as a natural stabilisation process following the investment explosion brought about by the "Go Out policy" in the 2000s, and should in no way be considered to indicate a reduction in investment activity by Chinese firms, i.e. China's investment continues to grow, just at a slower pace. The country's current FDI growth rates are unprecedented among the world's large economies. In 2015, China's FDI set a new record for the 13th year in row, surpassing USD 1 trillion of cumulative investment.

Chart 1 GDP and foreign investment (2006-2015)

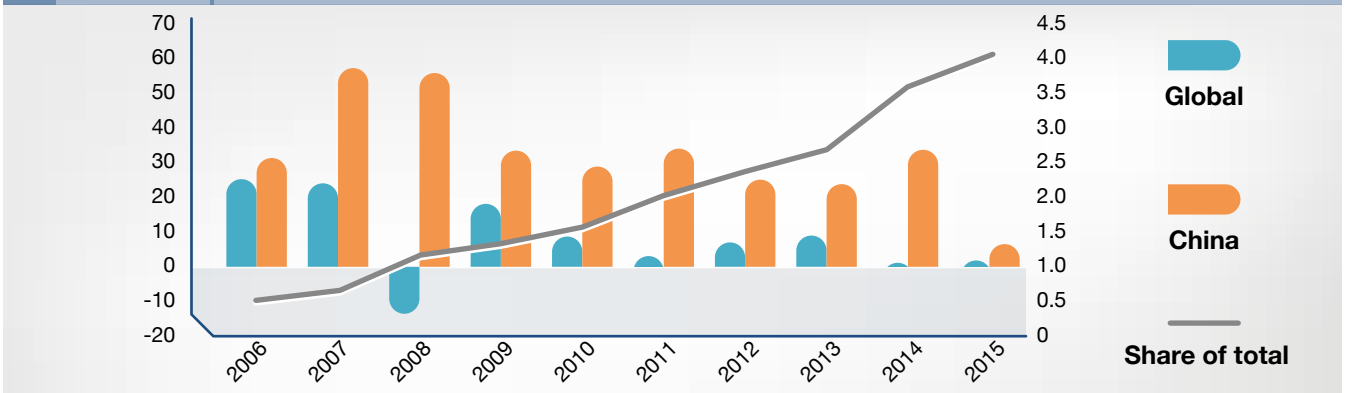


Source: own research based on IMF, MOFCOM and UNCTAD data. Left axis: % annual FDI and GDP growth; FDI is based on cumulative stock data published by MOFCOM up to 2014, to which the data announced by MOFCOM for 2015 have been added.

[1] Information published in the World Investment Report 2016, UNCTAD and consistent with MOFCOM data http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1555

[2] See: http://english.mofcom.gov.cn/article/statistic/foreigntradecooperation/201606/20160601331125.shtml

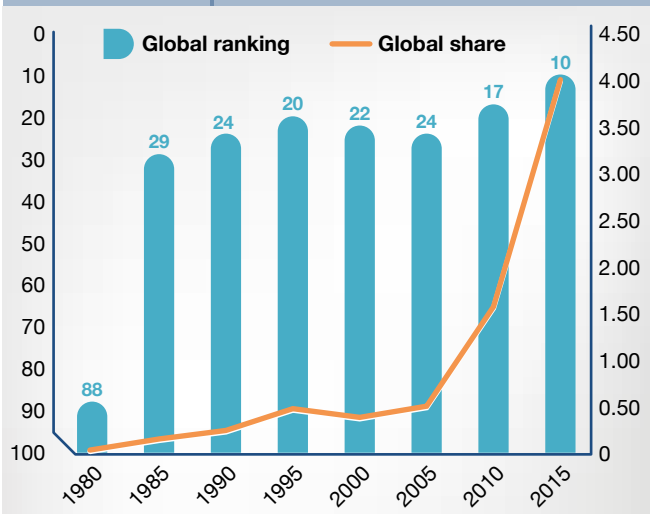
Chart 2 Chinese and global FDI – Share of total (2006-2015)



Source: own research based on UNCTAD and MOFCOM data. Left axis: % annual FDI growth. Right axis: China's share (%) of global FDI.

As can be seen in chart 2, China's exceptional growth in FDI led to an uninterrupted rise in its share of global foreign investment between 2006 and 2015 to become the 10th largest global investor in cumulative terms, having risen seven positions since 2010[3] (chart 3). In 2015, China became the world's third largest investor in terms of investment flows, surpassed only by the United States and Japan. Over the coming years, foreign investment is estimated to remain at similar levels or even go up due to factors that are explained further on, and China is expected to continue climbing the ranks as a global investor. According to our analysis, by 2023 the Asian giant could overtake the United States to become the world's leading investor.

Chart 3 Chinese position in the global ranking of foreign investment (1980-2015)



Source: own research based on UNCTAD data. The left axis shows the position in the ranking and the right axis shows Chinese foreign investment as a percentage of global foreign investment.

1.1 Consolidation of trends and new investment preferences

In 2014, 2015 and 2016 a consolidation of the main trends in Chinese investment abroad was seen:

- greater preference for advanced countries, particularly European countries;
- reconfiguration of Chinese investors' preferred investment sectors, with greater emphasis on services and industrial technology;
- rise in the number of private investors with respect to public investors;
- greater role of inland provinces in foreign investment;
- new investment preferences in terms of sector and geographical location.

The pattern of Chinese investment abroad is seeing a rapid transformation. Roughly speaking, the pattern of Chinese foreign investment in the 90s and 2000s entailed using financial capacity to take positions through SOEs in Sub-Saharan Africa and to access natural resources in Latin America, as evidenced by the construction of the airport in Sudan or the investment in Brazil by the oil company Sinopec. These operations continue to take place, although they are increasingly undertaken by private companies with their sights on other geographical areas and sectors, such as Lenovo's purchase of Motorola, which was previously held by the US company Google, or the real estate operation carried out by Dalian Wanda for the development of shopping centres in Paris, in 2015 and 2016, respectively.

[3] The impact of the foreign investment undertaken by Chinese companies is increasingly being documented in MOFCOM's statistical yearbook, which provides data showing a significant impact on job creation and the generation of tax revenues. With respect to jobs, the 29,700 Chinese companies that have invested abroad have created 1,855,000 positions, although the majority of these were in developing countries where China has invested primarily in labour-intensive sectors and mining and quarrying industries. Investment in developed countries has been of a very different nature, in capital- and knowledge-intensive sectors, where Chinese companies have created 135,000 jobs. With respect to tax revenues, in 2014 alone Chinese companies paid total taxes of USD 19.15 billion to various national tax authorities.

There are also significant exceptions to investment in commodities in developing countries and investment in manufacturing and technology in advanced countries. In addition to south-east Asian countries such as Malaysia and Indonesia, and Latin American countries such Brazil and Argentina, Chinese companies carry out large operations in the energy and mining and quarrying industries in developed countries such as Canada and the United States. For example, Chinese SOEs have acquired ownership interests in Canada in the energy companies Syncrude, Nexen and Novus, as well as stakes in numerous exploration and mining and quarrying projects. Chinese firms are also investing in knowledge-intensive sectors in developing countries. There have been a greater number of acquisitions of US and European companies in these types of sectors, although firms have also been investing in commercial and research activity in developing countries. For example, Huawei recently launched an innovation centre for smart cities in Porto Alegre (Brazil) in conjunction with Universidad de Rio Grande do Sul, and not long ago ZTE created an innovation centre together with the local telecommunications operator in Indonesia.

Although an increase in Chinese investment has been seen across all economic sectors, in recent years there has been a move away from industry in favour of services, primarily as a result of the aforementioned transformation of the Chinese economic model. In 2006 the industrial sector accounted for 30.3% of total investment, compared to 68.7% for the services sector. By 2014 the secondary sector had lost six points, falling to 24.2% of total investment, while services had risen to 74.8%.

Which sectors are seeing the greatest number of Chinese investments?

The sectors with the highest growth in investment between 2011 and 2014 are information technology (+59.8%), culture and entertainment (+70.4%) and the real estate sector (+49.6%). In the realm of information technology, a notable number of large Chinese companies, such as Lenovo, Legend Holdings, Huawei, ZTE and Tencent, which are spearheading technological change in the country, have become global enterprises. By way of example, the hardware and device manufacture Lenovo has undertaken large operations, such as the purchase of Motorola Mobility from Google, to become the third largest manufacturer of smartphones in the world6, or the formation of a joint venture with the Japanese company NEC to create the largest Japanese manufacturer of PCs. As a result of this vibrant investment activity, a growing number of Chinese technology companies have achieved some of the highest volumes of asset stocks held abroad, as can be seen in table 1.

Although China still has few truly international actors, it is investing substantial sums of money in the culture and entertainment sector. For example, in 2012 Dalian Wanda acquired the US company AMC Entertainment for USD 2.6 billion, giving the group chaired by magnate Wang Jianlin the second largest share of cinemas in the United States. In addition, there has been a recent flow of Chinese capital into various European football clubs, such as Atlético de Madrid and Real Club Deportivo Español in Spain or Inter and AC Milan in Italy. The real estate sector has gone from being barely significant

Table 1 The 15 largest Chinese companies in terms of asset stocks held abroad (2014)

	COMPANY	SECTOR	ASSET STOCKS HELD ABROAD	TOTAL ASSETS
1	China National Offshore Oil Corp	Mining	71,090	182,282
2	China Ocean Shipping (Group) Company	Transportation	44,805	57,875
3	Legend Holdings Corporation	IT equipment	26,957	47,062
4	China National Petroleum Corporation	Mining	22,857	641,334
5	China State Construction Engineering Corporation Ltd	Construction	22,440	149,670
6	Sinopec - China Petrochemical Corporation	Oil	21,943	362,873
7	China Minmetals Corp	Metal	19,225	59,010
8	Sinochem Group	Mining	18,706	57,867
9	Lenovo Group Ltd	IT equipment	16,791	27,081
10	China Mobile Limited	Telecommunications	10,556	211,117
11	China Electronics Corporation (CEC)	Data processing	10,226	38,157
12	Cofco Corp	Wholesale trade	10,225	70,888
13	Dalian Wanda Commercial Properties Co., Limited	Construction	9,189	91,891
14	Tencent Holdings Limited	Data processing	8,260	27,873
15	Fosun International Limited	Metal	8,212	52,897

Source: World Investment Report 2016. UNCTAD. Excluding financial sector entities. 2014 data. Asset figures in millions of dollars.

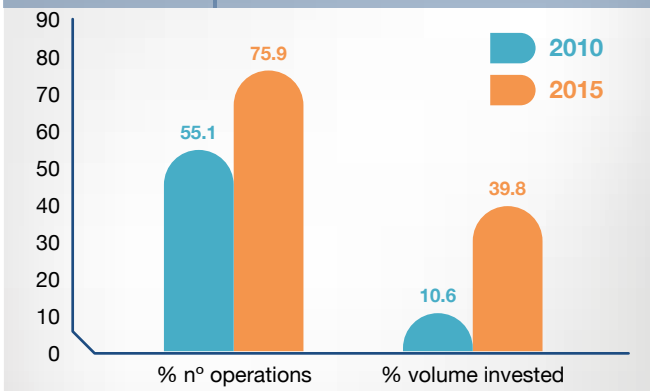
a few years ago, with no operations carried out, to become the seventh largest recipient of Chinese foreign investment at present. These operations fall into two categories. The majority are private investors looking to add premium buildings located in exclusive neighbourhoods in advanced countries to their asset portfolios. In other cases, Chinese investors have opted to acquire a property on which to develop real estate for subsequent sale at a profit. In any case, notable real estate purchases by Chinese investors are becoming increasingly commonplace in US and European cities. For example, various landmark buildings in New York are now owned by the Chinese, such as 767 Fifth Avenue, the Waldorf Astoria hotel, the General Motors Building, the Pacific Park projects in Brooklyn and 1 Chase Manhattan Plaza, as well as others in European cities, such as the Reuters headquarters in London and Palazzo Broggi in Milan.

Secondly, China's restructuring process has also impacted on its foreign investment. Inasmuch as Chinese firms are increasingly focusing their efforts on quality growth, many are investing in developed economies so as to access technology, experience and high-quality products, which can in turn help them to improve the value chain and be more competitive in the domestic and international markets. In view of its geographical proximity, Asia is perhaps a natural catchment area for Chinese firms looking to invest abroad; this region received 32.6% of cumulative Chinese investment up to 2014. Nonetheless, Europe and North America are also witnessing fast-growing investment from China. These regions received 16.5% and 11.5% of cumulative Chinese investment up to 2006, whereas by 2014 their share amounted to 24.9% and 21.2% of the total, respectively[4].

Thirdly, as the Chinese economy has progressively carved out greater room for the operations of private enterprises and the operating and financing barriers to internationalisation have been broken down, POEs (privately-owned enterprises) have been gaining ground abroad compared to SOEs (state-owned enterprises). With respect to the number of mergers and acquisitions abroad, 55.1% of all agreements in 2010 were executed by private firms, whereas in 2015 this percentage rose to 75.9%. Similarly, while private enterprises represented only 10.6% of the total value of M&A transactions undertaken abroad in 2010, they accounted for 39.8% in 2015 (see chart 4). Amongst the largest private groups in China with a growing international presence are the automobile manufacturer Geely, the entertainment and real estate giant Dalian Wanda, the energy company CEFC China Energy, the steelworks company Jiangsu Shagang Group, the technology companies Huawei and Legend Holdings (majority shareholder of the technology manufacturer Lenovo), the textile firm Shandong Weiqiao Pioneering, and Fosun, possibly the private Chinese group with the highest level of investment activity in Europe.

In fourth and final place, a trend worth mentioning is the rising number of new Chinese provinces with a growing number of companies investing abroad. Despite the increasingly common view that economic growth in China is two-tiered, characterised by a widening gap in development between coastal and inland provinces, in recent years there has been an upswing in the number of Chinese companies hailing from provinces located far from the coast with the capacity to invest abroad. Although the provinces of Guangdong, Shanghai and Beijing continue to overwhelmingly house the headquarters of the private and public companies with the highest levels of foreign investment, the outbound FDI of inland provinces climbed by over 200% per year in the period from 2006 to 2014. In fact, as seen in chart 5, the outbound FDI of inland provinces in the period considered increased from 14.6% to 20.5% of the total, which is one of various economic indicators showing that the Chinese development model is trending, albeit modestly, towards a greater regional balance.

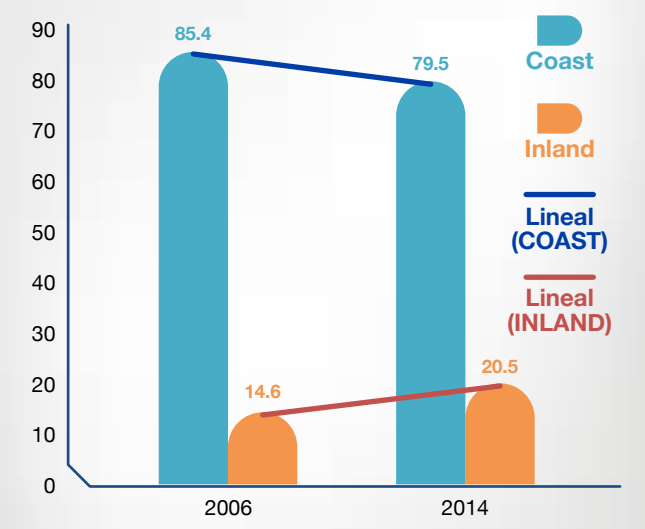
Chart 4 Foreign investment by privately-owned enterprises (POEs) (2010-2015)



Source: "China Outlook 2016". KPMG Global China Practice, based on Dealogic data.

[4] "China Outlook 2016". KPMG Global China Practice. 2016. Prepared on the basis of data from MOFCOM, NBS and the State Administration of Foreign Exchange. The figures do not include Chinese investment in Hong Kong, the British Virgin Islands or the Cayman Islands.

Chart 5 Percentage of investment originating from coastal and inland provinces (2006-2014)



Source: own research based on MOFCOM data.

1.2 Change in the growth model to stimulate the internationalisation of Chinese companies

The profound transformation taking place in the Chinese economy's production model, which is explained in the first part of this report, will have a great influence on Chinese investment abroad in the coming years. In general, we consider that although certain factors will act as a boost and others as a drag, the overall effect will be positive and, therefore, the change in model represents an additional stimulus for more companies to invest abroad. The factor expected to have the greatest positive influence on foreign investment will be the demands posed by the transition towards a model with a greater contribution from sectors and activities that are more value-, knowledge- and technology-orientated, which will require local businesses to acquire these capacities. At internal level, this change is being catalysed by various public stimulus initiatives for companies to advance in the area of technology, such as Internet Plus or China 2025, supplemented by innovation investment in both Chinese and foreign enterprises. At external level, Chinese firms have found a quicker way of developing, by investing in firms in developed countries, such as the United States or European countries, in order to access technological resources and innovative products/services that will enable them to develop or increase their competitive edge[5].

Other factors that should boost the internationalisation of Chinese firms are the current industrial overcapacity and the financial liberalisation. The surplus installed capacity of a considerable number of large public enterprises has increased the incentive for their international expansion, through either the export of commodities and manufactured goods, access to operating contracts or foreign investment. In this respect, as pointed out in the first part of this report, one of the objectives of the One Belt, One Road strategy is precisely to expand the market for major Chinese state-owned enterprises, thereby offering a partial solution to their overcapacity. The financial liberalisation and the internationalisation of the yuan should also favour the greater internationalisation and presence of Chinese companies abroad. The Chinese government and its monetary authorities in particular are determined to bring about total financial liberalisation, albeit in a gradual and orderly manner, having already taken important steps in this direction. This process should encourage an increase in the number of foreign investment operations, particularly by private investors. In addition, the government's ambition to position the yuan as a global benchmark currency, not just to be held as reserves but also for use in commercial transactions, should also give foreign investment operations a boost.

Conversely, two significant factors that could have a negative effect on foreign investment are the recent financial volatility and the debt levels of SOEs. The episodes of financial volatility seen in 2015 and 2016, which primarily affected the Shanghai and Shenzhen stock markets, led to a significant outflow of capital that raised concerns about the stability of the financial system and the yuan. As a result, the Chinese authorities adopted certain control measures that make it harder to invest abroad. In any case, these restrictive measures are expected to be a temporary response to specific incidents of capital outflow. In the long term, the trend is clearly towards greater liberalisation and the promotion of foreign investment. However, the high debt levels and difficulties confronting certain SOEs could influence their foreign investment decisions. The usual strategy has involved making leveraged buyouts abroad using borrowings from public entities, but given the current debt levels of the companies requesting the loans and the financial position of certain lender funds and banks, the number of major leveraged operations financed by public entities could see a decline in the coming years.

[5] The advantages for Chinese investors of purchasing a large manufacturing company are not merely the access to knowledge transfer, but also production capacity, expansion of their market and improved brand profitability. When Geely Holding Group acquired 100% of Volvo in 2010, which until then had been the property of Ford Motor Company, the vice-chairman of the Chinese company listed all the advantages that the operation afforded the company: an internationally recognised brand, intellectual property rights over 10,963 patents, ten production platforms with environmental criteria, 3,800 engineers and 3,235 sales offices in 100 countries.

2. Chinese investment in the European Union

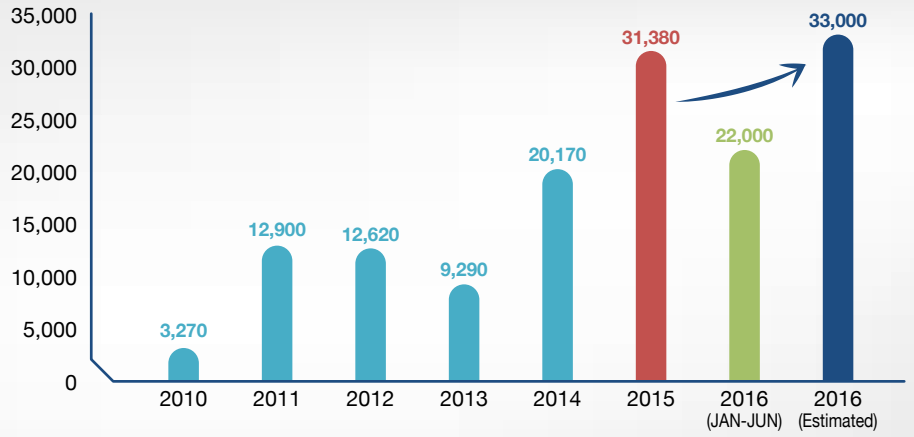
Chinese companies increased their commitment to the European Union in 2015, setting a new record for investment in the European continent. Europe is not only China's main global trading partner but also the primary destination of its foreign investment after Asia, the natural catchment area for Chinese companies looking to expand. The attraction of Europe for Chinese companies is clear: political and macroeconomic stability; a predictable, transparent investment environment; 500 million potential consumers with high purchasing power; highly qualified workers and executives; assets such as state-owned enterprises and real estate properties that offer stability and low risk; and industrial companies that can help to increase technological capacity and innovation. In 2015 and 2016 these structural factors were joined by other short-term aspects, including consolidation of the economic recovery in Europe, particularly the Eurozone; the strength of the yuan at various times during the year, posting a rate of CNY 6.58 per euro on 13 April 2015; and Chinese companies' growing interest in acquiring European firms, in view of the shift in China's growth model.

As a result of these factors, in 2015, the last complete year for which data are available, Chinese investment in the European Union amounted to USD 31.38 billion (approximately €28.61 billion)[6] according to the ESADE China Europe database, an increase of 55% vis-à-vis 2014. This was the third consecutive year of growth for Chinese investment in the European Union and the first in which it surpassed the USD 30 billion threshold (see chart 6)[7]. The spectacular increase was primarily the result of two major deals, the largest by Chinese investors in Europe to date: ChemChina's acquisition of Italian firm Pirelli (USD 8.98 billion) and HNA–Bohai Leasing's purchase of the Irish company Avolon (USD 7.6 billion).

During the first half of 2016 (January-June) investments amounting to USD 22 billion had been announced, leading us to estimate that Chinese investment in the European Union could reach a new all-time high in 2016, topping the USD 33 billion mark.

The lion's share of Chinese funds in 2015 went to Italy, which received USD 10.31 billion (32.9% of total investment in Europe) in the largest transaction seen in Europe to date: the acquisition of the tyre manufacturer Pirelli by China National Chemical Corp (ChemChina), which accounted for nine out of every ten dollars invested by China in Italy last year. The transaction was carried out in two tranches, the first comprising the acquisition of 26% of the company from Camfin, another Italian concern, and the second entailing the purchase of the remainder of the shares from JP Morgan and Russian energy giant Rosneft. The investment forms part of ChemChina's strategy to diversify its activities in the local market with a view to becoming a tyre supplier to Italian automobile manufacturers. Chinese investments in Italy will be analysed in the section on investment in southern Europe.

Chart 6 Chinese investment in the European Union (2010-2016)[8]



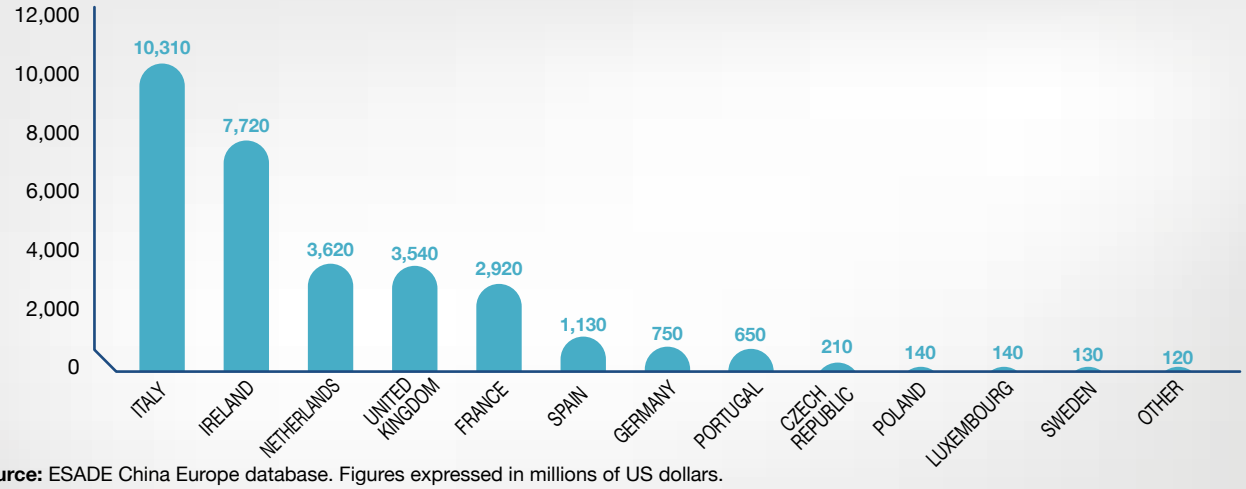
Source: Own research based on the ESADE China Europe database. Figures expressed in millions of US dollars.

[6] Average exchange rate in 2015: €1.097 per USD (for transactions in other years we have used the average annual exchange rate for the year in question or, for transactions in US dollars, the original amount shown in the database.)

[7] The ESADE China Europe database encompasses investment transactions in the European Union between 2010 and 2015, a period that takes in almost all Chinese investment in the region. According to official figures published by MOFCOM, 88.4% of Chinese investment in the European Union has materialised since 2010.

[8] Cumulative investment in the European Union in the 2010-2015 period totalled USD 89.7 billion. There is a difference of USD 70 million when investments for each of these years are combined, due to rounding of certain transactions over a five-year period (2010-14). We consider this an acceptable error in view of the amounts involved.

Chart 7 Chinese investment in the European Union. Geographical distribution (2015)



Source: ESADE China Europe database. Figures expressed in millions of US dollars.

Ireland, which until then had not been on the receiving end of any significant Chinese investment, was the second most popular investment destination in 2015, following the purchase by aviation and transportation group HNA of the aircraft leasing firm Avolon, a transaction valued at USD 7.6 billion, including USD 5 billion in debt. The Dublin-based firm owns 150 aircraft in 33 countries and the arrival of the Chinese investor will contribute to Avolon's expansion into Asia, as well as increasing its financial clout. Through this transaction the Chinese group hopes to become a global leader in the aviation sector, particularly the aircraft leasing segment, expanding the scope of its activity, hitherto limited to China, beyond its confines.

After Italy and Ireland, the three major European economies continued to be the preferred destination for Chinese investment in Europe in 2015; the United Kingdom, France and Germany jointly received 23% of Chinese investment in Europe (see chart 7). The patterns of Chinese investment in each of these countries were observed to consolidate and deepen last year. Attracting investments of USD 3.54 billion, the United Kingdom was once more in Chinese investors' sights on the strength of its real estate sector, particularly in London, which boasts assets of sufficient value to suit the strategy of Asian investors while offering a moderate risk profile. Last year saw acquisitions such as that of the Milton Gate office building in the City of London by Taikang Life Insurance Company, or the purchase of a property valued at close to USD 100 million by billionaire Wang Jianlin, the richest man in China. The real estate arm of private investment giant Fosun – which already acquired the Lloyds Chambers building in London in 2013 – then announced a new joint venture with the British property group Resolution Property, which owns a wide range of real estate properties in several European markets, with a view to exploring further acquisitions in the United Kingdom[9].

France, once again one of the favourite destinations for Chinese companies in Europe, was on the receiving end of USD 2.92 billion. The largest transaction, which accounted for one third of Chinese investment in France last year, was the acquisition of several shopping centres previously in the hands of CBRE Global Investors by the sovereign wealth fund CIC[10], which already owned real estate assets in London. CIC appears to be taking advantage of CBRE Global Investors' need for cash to acquire shopping centres such as La Vache Noire on the outskirts of Paris, and two others in Belgium. In doing so, CIC – one of the world's largest sovereign wealth funds, with USD 653 billion of assets under management – is demonstrating its willingness to once more increase its exposure to European real estate. The other headline-grabbing transaction was the acquisition by Fosun (through Gaillon Invest) of the tourism and resorts operator Club Méditerranée (Club Med) for USD 1.2 billion. The deal marked the culmination of two years of negotiations in which Fosun finally won out over Italy's Investindustrial Group.

Chinese companies also continued to invest in Germany. In 2015, investment in the largest economy of the Eurozone was USD 750 million, lower than in previous years and mainly directed at the manufacturing industry and the logistics and transport sector. Last year, as in previous years, numerous deals were made, although for smaller amounts, thus reducing the total volume of incoming investment. Nevertheless, transactions followed the same pattern: acquisition by a Chinese industrial company of a non-controlling interest in a medium-sized German manufacturing concern. Such a shareholders' agreement offers Chinese companies access to new know-how and technology while providing German targets with a combination of financial clout and access to other markets. The largest transaction of this type carried out last year was the acquisition of WEGU Holding, a maker of suspension systems and shock absorbers, by the Chinese

[9] China Investment Corporation

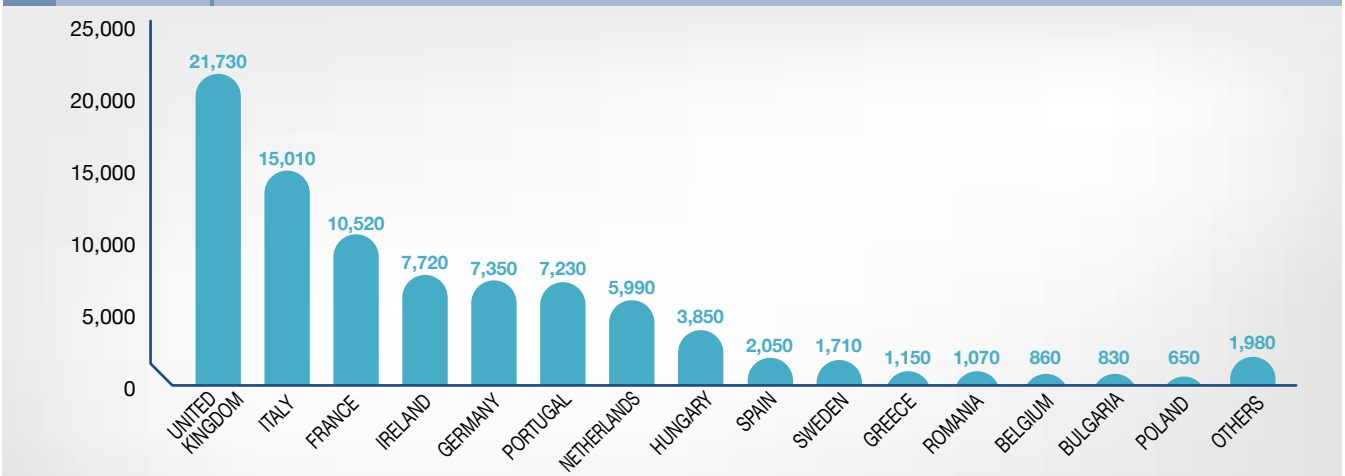
company Anhui Zhongding for USD 107 million. In addition to the investments in the German manufacturing sector, one of the most significant transactions last year was the purchase by Fosun of Hauck & Aufhäuser, a German private bank, for USD 230 million. Fosun, which has already been involved in numerous deals in Europe, appears increasingly interested in raising its exposure in the financial sector, having expressed interest in the acquisition of Belgian bank BHF Kleinwort Benson Group SA.

The Netherlands and Spain are two other countries where China made significant investments in 2015. The USD 3.62 billion channelled into the Netherlands pertains mainly to accounting factors: an attractive tax and regulatory framework for holdings of European companies means that significant Chinese investments are accounted for there. Nevertheless, there were some sizeable acquisitions of Dutch companies last year, including NXP Semiconductors, which is present in over 30 countries but has its headquarters in Eindhoven, and the financial services company Vivat Verzekeringen. Spain, on the other hand, welcomed investments of USD 1.13 billion in 2015, the first time that the USD 1 billion threshold has been broken. This was largely attributable to a transaction that took place in the energy sector, the acquisition of an interest in Madrileña Red de Gas by Gingko Tree Investment, the investment arm of the SAFE fund, for USD 730 million. The remainder was made up by Chinese investors who continued to invest in the agribusiness sector, in which Spain is very strongly positioned with regard to Asian investors. Specific transactions included the acquisition of the Marqués de Atrio winery and Miquel Alimentació, a food distribution company, among others. In this same sector, 2016 will bring new deals on top of those sealed in 2015, including the acquisition of Albo, a canning company. The investments of Chinese companies in Spain will be analysed in greater detail in the section on investment in southern Europe.

Analysing the aggregate data for the 2010-15 period (see chart 8), we can see that the three main European economies – the United Kingdom, France and Germany – are still the main destination of Chinese investment in Europe, attracting 44.1% of the total for the period. Of all the countries in Europe, the United Kingdom received the lion's share of Chinese investment in the 2010-15 period; specifically USD 21.73 billion, equivalent to 24.2% of the total. France is in third place behind Italy, with USD 10.52 billion (11.7%), while Germany ranks fifth in terms of cumulative investment, with USD 7.35 billion (8.2%). However, having become more attractive to Chinese investors in recent years, southern European countries are already raking in 28.3% of total cumulative Chinese investment, making them the second most appealing group of European countries for Chinese firms. At the top of the list is Italy, with USD 15.01 billion (16.7% of the total for Europe), followed by Portugal with USD 7.23 billion (8%) and, trailing at some distance, Spain with USD 2.05 billion (2.3%) and Greece with USD 1.15 billion (1.3%). Other European countries that have received a considerable volume of Chinese investment in the period analysed are Ireland (USD 7.72 billion), the Netherlands (USD 5.99 billion) and Hungary (USD 3.85 billion).

Turning to analyse the sectors that attract investment and reflecting the previously stated interest of the Chinese in acquiring technological and other specialist capabilities, manufacturing was the sector that most attracted Chinese investment to the European Union in 2015 (see chart 9), accounting for 39.4% of the total (USD 12.38 billion), although much of this was due to the acquisition of Italian tyre maker Pirelli. The second most popular sector to invest in was logistics and transport, which in 2015 hosted the acquisition of the Irish company Avolon (USD 8.12 billion, 25.9%) along with eight other transactions. Notably, as described below, the Port of Piraeus management and investment contract, valued at over USD 400 million, was awarded to COSCO in 2016. This con-

Chart 8 Cumulative Chinese investment in the European Union. Geographical distribution (2010-2015)



Source: ESADE China Europe database. Figures expressed in millions of US dollars.

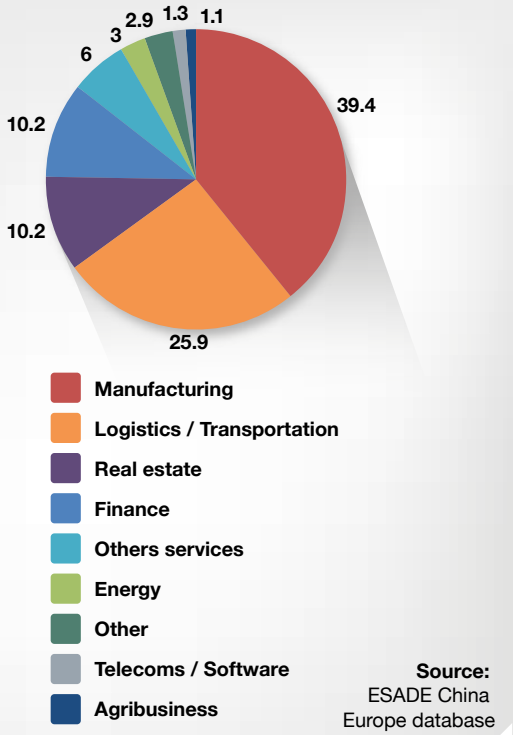
tract is closely related to the OBOR project. In 2015, the financial and real estate sectors shared third place as recipients of incoming investment. In the financial sector (USD 3.2 billion, 10.6%) there were three major transactions: the acquisition of Dutch insurer Vivat Verzekeringen by Anbang Insurance Group for USD 1.54 billion; the purchase of Italian insurer Assicurazioni Generali by People's Bank of China for USD 570 million; and the purchase, begun in 2014, of the Portuguese company Espirito Santo Saúde by Fosun, valued at USD 621 million. In the real estate sector (USD 3.2 billion, 10.6%) the aforementioned projects by private investors such as Wanda in France or the Fosun Group in Italy stand out. In this sector, the main country on the receiving end is still the United Kingdom, which attracts 1 out of every 3 dollars invested. Behind it is France, a country where investments for up to USD 3 billion are proposed in a leisure centre on the outskirts of Paris, and Italy, where the Fosun Group acquired the Palazzo Broggi in Milan (USD 381 million).

Investment in services other than those in more consolidated sectors of activity continues to grow (6% with incoming investments of USD 1.9 billion). The energy sector (USD 940 million, 3%) has been less visible than in other years, although significant transactions have taken place, including the SAFE sovereign wealth fund buying into Madrileña Red de Gas, a Spanish gas operator, for USD 730 million, and the acquisition of several wind farms in Poland by China Three Gorges. The telecommunications sector also maintained a lower profile, with transactions totalling USD 400 million (1.3%), followed closely by investments of USD 330 million (1.1%) in the agribusiness sector.

Analysing the aggregate data for 2010-15 (see chart 10), the distribution of Chinese investment by sector is greatly concentrated in three sectors: manufacturing (USD 20.24 billion or 22.6% of the total), energy (USD 19.12 billion or 21.3%) and real estate (USD 16.56 billion or 18.5%). The relative weight of these three sectors, which together account for more than 6 out of every 10 dollars invested in the European Union by China, is especially high because a considerable number of transactions, particularly in the energy sector, call for large volumes of investment. The sector that receives the fourth largest amount of Chinese investment is logistics and infrastructure at USD 10.69 billion (11.9%), followed by finance at USD 6.46 billion (8.3%), agribusiness at USD 5.22 billion (5.8%) and telecoms and software with USD 4.56 billion (5.1%).

Chart 9

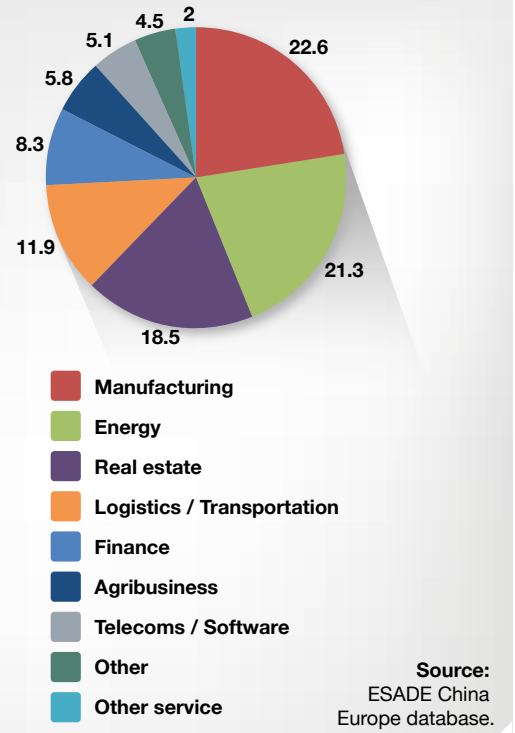
Chinese investment in the European Union.
Sector distribution (%) (2015)



Source:
ESADE China Europe database

Chart 10

Cumulative Chinese investment in the European Union.
Sector distribution (%) (2010-2015)



Source:
ESADE China Europe database.

Explanatory note:

ESADE China Europe 2010-2015 database

Official information sources, whether Chinese, European or North American, have various limitations when it comes to reflecting the reality of Chinese investment in the world. The large number of transactions carried out through tax havens and OFCs, system limitations when registering investments, and the considerable delay in publishing statistics all limit their explanatory capacity, making it very difficult to adequately monitor Chinese investment carried out solely through these channels.

As with the last edition of this report, and in line with the practices of other institutions vis-à-vis the North American market, ESADE China Europe has therefore compiled its own database to evaluate Chinese investment in the European Union, encompassing the 2010-2015 period and the first half (January to June) of 2016. This database (referred to throughout this report as the ESADE China Europe database) combines the private information sources Dealogic, Heritage Foundation and Mergermarkets[10] for M&A transactions, FDI Markets[11] for greenfield operations, and our own research and monitoring of press coverage of other significant transactions. The database only covers transactions originating in continental China (referred to throughout this report as Chinese investment). As such, the amounts recorded do not take into account transactions conducted by Hong Kong-based firms.

However, the ESADE China Europe Observatory, which for now focuses solely on monitoring the presence of Chinese enterprises in Spain, also includes Hong Kong-based companies.

The China Europe database enables the main destinations of Chinese investment in the 2010-2015 period to be identified, both by geographical location and by sector. During this period investments totalled USD 89.7 billion, which is around 85% of the cumulative investment, meaning that the database provides information on almost all Chinese investment in the European Union since the commencement of the investment relationship between the two economies.

Disclaimer of liability for errors or omissions

In view of the difficulty and complexity of obtaining accurate data, although maximum care was taken and the greatest of efforts was made in preparing this database and when using the data in the report, the author of this report assumes no liability for any possible error or omission, or for any damage and loss derived from the use of or reference to the information contained herein.

2.1 2016: approaching USD 100 billion of Chinese investment in the European Union

Several transactions involving Chinese investment in the European Union have taken place in 2016, which will presumably push annual investment to over USD 30 billion once again and cumulative investment since 2010 to over USD 100 billion (USD 89.7 billion at the end of 2015). At least two large investment transactions have taken place in 2016: one between Chinese home appliance manufacturer Midea and German robotics manufacturing firm Kuka, valued at USD 5 billion, and a major real estate transaction in the shopping centre segment by Dalian Wanda, which acquired the entertainment complex Europa City on the outskirts of Paris, for some USD 3 billion.

A further five transactions, some of which involve firms until now controlled by international venture capital funds and valued at over USD 1 billion, are expected to take place in Europe. For example, in a new transaction in the European luxury goods segment, Shandong Ruyi could acquire control of the luxury goods firm SMCP, which is currently held by venture capital fund KKR, for USD 1.5 billion. Meanwhile, Chinese investment group Creat may invest in health sciences company Bio Products Laboratory, until now held by the venture capital fund Bain Capital Private Equity, for USD 1 billion. Other significant transactions could take place in the environmental sector. These include an agreement reached by Beijing Enterprises Holding for the acquisition of EEW Energy, a German company specialising in waste management and clean energy solutions for companies and homes, for USD 1.6 billion; the acquisition of Aldgate Tower in the City of London by China Life Insurance; and the purchase of 17 Columbus Courtyard in Canary Wharf by HNA. Moreover, 2016 has brought the long-awaited award of the Port of Piraeus in Athens to the China Ocean Shipping Company (COSCO) group, in a transaction that could entail an investment of up to USD 1.5 billion.

Lastly, in addition to Chinese FDI in the European Union, ChemChina – which was already at the centre of the largest Chinese investment in Europe in 2015 – could once more close the biggest Chinese investment deal abroad in 2016, in a European country, albeit outside the European Union: Switzerland. Specifically, 2016 could bring confirmation of the acquisition of Swiss seed giant Syngenta in what would constitute the largest foreign investment transaction in the world to date, possibly amounting to USD 43 billion. The investment rationale for the transaction is clear: China has 21% of the world population but only 9% of arable land.

[11] Data provided by Cuatrecasas, Gonçalves & Pereira
[12] Data provided by ACCIÓ-Catalonia regional government

Box 1.

The United Kingdom and the new Brexit scenario

On 23 June the United Kingdom agreed in a referendum – albeit by a very small majority – to leave the European Union, thereby commencing the process of departing from the European project in which it has played a part since 1973. Whether or not this new scenario will lead to the United Kingdom becoming more or less attractive to foreign investors will depend mainly on two factors. On the one hand, the exit negotiations between London and Brussels, the central scenario being an "amicable divorce" whereby the potential negative impact on the two economies is kept to a minimum where both trade and financial investment are concerned. On the other hand, the compensation and incentives offered to foreign investors by the British government, which have already begun to be announced, such as the reduction in corporate income tax to 15% proposed by George Osborne, Chancellor of the Exchequer.

In particular, the impact of this new scenario on Chinese investment in the United Kingdom should be considered. Up to now the United Kingdom has been the main destination for Chinese investment in the European Union, accounting for a cumulative amount of USD 21.73 billion from 2010 to 2015, far ahead of other large European economies such as Italy, France or Germany. Although in the short term certain operations may be postponed due to the current uncertainty (the "wait and see" approach), a drop in China's investments in the UK is not expected in the medium to long term, and in any case not all investments would be equally affected by Brexit; it may even have a positive impact in some cases.

Firstly, in the case of investments aimed at accessing technology and strategic assets, which will foreseeably be the motivating factor behind most operations in the coming years, as explained throughout this report, the Brexit effect should be neutral. Chinese companies will continue to invest in firms that provide them with comparative advantages internationally, as they are already doing in other advanced countries, regardless of whether or not they form part of supra-national projects, as is the case in Europe. For example, a significant Chinese transaction in the European region that may be finalised this year is the acquisition of the seeds giant Syngenta, a Swiss firm outside the European Union.

Secondly, as regards investments aimed at accessing the continental European market, either through exports or financial transactions, Chinese investments may be negatively affected by the United Kingdom's departure from the European Union. In any case the impact on exports should not be excessive as this factor has little bearing on Chinese investments in the United Kingdom; indeed, exports may hardly be affected at all if London and Brussels reach a trade agreement that is advantageous for both parties, as is expected. The impact could be greater for Chinese financial firms interested in establishing their European headquarters in London, an attractive hub for Chinese investors and banks wishing to access various financial markets and assets, including issues and transactions in yuan. This also depends on the extent to which the international financial operators stop using the City as their main European financial hub and leave the United Kingdom.

Thirdly and lastly, in the case of property transactions such as real estate acquisition – for which the city of London, comparable only to New York, has been the main destination of Chinese investors up to now – or minority shareholdings in other assets, including state-owned assets, the effect could be positive, given the lower prices as a result of the sudden decline in value of the pound sterling compared to its pre-Brexit levels. Another potential positive impact of the United Kingdom's currency depreciation could be an increase in Chinese tourism, which would also be an incentive for more investments in this sector, as has already happened in countries such as Spain and France.

To sum up, at ESADE China Europe we consider that the United Kingdom will continue to be one of the main recipients of Chinese companies' global investments and that the positive or negative effect of Brexit will differ depending on the investor's target sector.

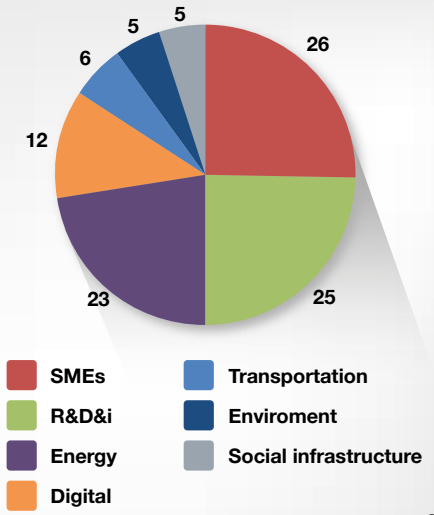
2.2 Complementary nature of European and Chinese initiatives: a driver for new investment

The large-scale investment and innovation programmes entered into by the European Union and China in the last two years, and currently being implemented, complement each other in ways that should strengthen the links between the two regions and stimulate Chinese investment in the European Union over the coming years. Specifically, the European Fund for Strategic Investments (EFSI), a short-term plan better known as the Juncker Plan, and Horizon 2020, a long-term plan, could help stimulate Chinese investment in Europe. On the Chinese side, the One Belt, One Road (OBOR) project is already resulting in a higher number of Chinese investments in Europe, primarily in the infrastructure and logistics sectors.

Introduced in July 2015, the Juncker Plan is the EU's main programme for stimulating demand. Brussels' aim is for the Plan to act as a catalyst to generate investments of €315 billion (USD 345.24 billion) in Europe up to 2018, taking advantage of the abundance of liquidity and the current low cost of capital, as interest rates are at an all-time low. Despite initial scepticism among both public agencies and the private sector in Europe, the Plan has begun to produce the first results as a promoter and catalyst for new investment. By July 2016, the plan had given rise to investments of €115.7 billion (USD 126.04 billion), 37% of the target for the three-year plan, involving 289 transactions in 26 of the 28 states that make up the European Union[13]. According to the European Investment Bank (EIB), the countries that have made the greatest use of the plan are France, Italy, the United Kingdom, Germany, Slovakia, Belgium and Spain. Until July 2016, 74% of projects by volume were in the energy sector, R&D&i[14] and SMEs (see chart 11).

Chart 11

Projects approved under the Juncker Plan, by sector, as a percentage of the total (until July 2016)



Source: European Investment Bank (EIB)

The Chinese authorities have shown an interest in taking part in the Juncker Plan through investments and projects of between €5 billion and €10 billion (USD 5.48 billion - USD 10.96 billion), and in September 2015 a working group was created to push forward the projects into which these resources will be channelled. If China does eventually contribute €10 billion (USD 10.96 billion) to the Juncker Plan, it will become not only the first non-European country to take part in the scheme, but also one of its biggest backers. In this respect the projects financed to date are in line with those already being financed or carried out in other regions by China, particularly in energy and technology. Furthermore, according to Jean-Claude Juncker, President of the European Commission and promoter of the Plan, the EFSI could be extended beyond 2018.

The purpose of Horizon 2020 is for the European Union to attain a position of global leadership in corporate innovation and to act as a catalyst for various initiatives that have as their purpose to make Europe a benchmark across different industries in the future. The budget for this initiative is €80 billion (USD 87.68 billion), to be invested in the 2014-2020 period. China had already played a prominent role as financier and executor of projects under the 7th Framework Programme of the European Union, and has now been invited to play an active role in research and development projects included in the Horizon 2020 initiative. The European Union has published a list of tenders for European projects in which China has been specifically invited to take part. Note that China and the European Union have a co-financing mechanism in place for the purpose of conducting joint research projects[15].

Besides joint research projects, what is truly interesting about Horizon 2020 is that it will contribute to shifting the European corporate scenario towards new sectors and activities that add considerable value, as these are precisely the areas Chinese investors are most interested in during this new phase of transformation of the production model. Brussels' aim is for European industry to make advances in sectors such as green technologies, biotechnology, nanotechnology and the maritime industries as these are the types of assets that Chinese investors will be looking for in European companies in the coming years.

As for Chinese initiatives, Europe is a cornerstone of the OBOR project, in view of its 500 million consumers that make it the largest affluent global market, and its position as China's main trading partner. The OBOR initiative will fuel investment in Europe through a threefold strategy. Firstly, through the participation of Chinese companies in European infrastructure and logistics platforms, with the dual aim of controlling the distribution chain of Chinese products and expanding logistics capacity. Investments of this nature have been seen recently.

[13] http://www.eib.org/efsi/
[14] Research, development and innovation
[15] See: https://ec.europa.eu/programmes/horizon2020/sites/horizon2020/files/List%20of%20calls%20targeting%20China%20in%20Horizon%202020%20work%20programme%20for%202014%20and%202015_2.pdf

In the last two years China has invested in various infrastructure projects such as ports, foremost amongst which are Barcelona (Spain), Naples (Italy) and, more recently, Piraeus (Greece), and airports, such as Toulouse (France) and Manchester (United Kingdom).

Secondly, the Chinese government is already working on land infrastructure in various countries with a view to reducing logistics times and costs. Once they are completed, they will provide Chinese companies with an additional incentive to invest in Europe.

Thirdly, there are clear synergies between the plans for Europe set out in the OBOR project and those of the aforementioned Juncker Plan, which could stimulate joint investments in which the AIIB, one of the main financiers of the Chinese initiative, could take part. Nevertheless, it is hoped that the European Union, which at the moment is focused on urgent matters such as the United Kingdom's exit from the EU, the refugee crisis or the approval of the third Greek bailout, will in the near future pay more attention to the integration of the two initiatives.

2.3 Chinese investment in the United States and the European Union. What are the differences?

Chinese investment has risen sharply in recent years in both the European Union and the United States, reflecting the growing presence of Chinese companies in the two economies. In 2015, the last full year for which data are available, the volume of Chinese investment reached an all-time high of USD 31.38 billion in the European Union and USD 15.3 billion in the United States[16]. Both economies share common features that support the interest of Chinese companies in investing: political and macroeconomic stability; a large, high-income market; highly qualified talent and labour; high-tech companies; and brands that enjoy global recognition. Furthermore, the authorities in both the European Union and the United States are very interested in attracting Chinese investment, as shown repeatedly through bilateral meetings held at the highest level, and both are currently engaged in talks aimed at signing a new investment treaty with China. In summary, in a context of growing investment by China in developed countries, the European Union and the United States constitute the prime investment destinations for Chinese companies. Nevertheless, there are significant differences in terms of the pattern of Chinese investment on either side of the Atlantic. These differences mainly relate to the investment sectors, the nature of the investor company (state-owned or private) and the type of transaction (M&A or greenfield).

Possibly the main difference between the pattern of investment by Chinese companies in the United States and that in Europe lies in the preference of Asian companies for certain sectors in each of the two economies. Chinese investors show greater interest in the technology sector and the entertainment industry in the United States, whereas in Europe they favour energy, logistics and infrastructure. Technology giants such as Huawei, ZTE, Tencent or Baidu have made significant investments in both Europe and the United States. However, the number of major transactions in the latter is observed to be higher. Large-scale technology deals in the United States date back to the acquisition of IBM by Lenovo in 2005 in what was the first major transaction in this sector between China and a developed country. It demonstrated China's capacity to become a global player in sectors other than commodities and minerals. Since then, Lenovo has been involved in other weighty deals, the latest being in 2015 when it acquired Motorola Mobility, a transaction valued at USD 3.14 billion. Furthermore, Chinese investors are beginning to invest in US start-ups with increasing frequency. Alibaba, the e-commerce giant, recently acquired SnapChat, a California-based start-up specialising in instant messaging, for USD 200 million, and China Life Insurance invested USD 200 million in Uber (which would subsequently invest in its biggest rival in China, the mobility application Didi Chuxing)[17-18].

In addition to the technology sector, Chinese companies have shown great interest in investing in certain sectors related to the entertainment industry in the United States. China's fondness for this sector also reflects the rationale of acquiring stakes in global leaders in the entertainment sector, sometimes controlling the entire value chain, from film production to cinemas. In one of the largest deals ever seen in the history of the entertainment sector, Dalian Wanda acquired ACM, a chain of cinemas until then owned by US private equity giant Apollo & Bain, for USD 2.5 billion. In addition to a penchant for movie theatre management, Chinese investors have also shown interest in channelling funds into Hollywood production companies to gain access to the world's largest film market, investing in firms such as SXT Entertainment, in which Chinese private equity fund Hony Capital has acquired an interest.

[16] Data on Chinese investment in the European Union from ESADE China Europe; data on Chinese investments in the United States from Rhodium Group. According to data from the latter source, Chinese investment in the United States in the first half of 2016 reached USD 18 billion, while transactions valued at USD 33 billion were expected to be concluded. Therefore China's investment in the United States in 2016 could exceed its investment in the European Union (http://rhg.com/notes/chinese-fdi-in-the-us-tripling-down-on-america)

[17] The fact that the United States has become a target market for Chinese capital on the technology front, at the expense of Europe, reflects the technological divide between the two sides of the Atlantic. The United States invests more in R&D than Europe and has a much more highly developed venture capital industry. Americans are more entrepreneurial, and the regulatory environment is more favourable for innovation. It is therefore understandable that when Chinese companies seek to acquire capital stakes in highly innovative technology companies, their preferences lie with the US. Looking just at the number of unicorns (start-ups valued at over USD 1 billion), the United States is home to 128 unicorns, compared to 38 in Europe.

[18] Several recent projects presage a surge of interest in the technology sector in Europe, although without reaching the levels attained in the US. Secondly, in the previous edition of this report, we already commented on the growing interest in European start-ups, as borne out in 2016 by the announcement made by Cocoon Networks, an investment group backed by China Equity Group and Hanxin Capital. Investors have announced the creation of a venture capital fund based in London with a seed capital of USD 721 million that will invest in European tech start-ups. This is the first fund backed by Chinese investors acting as limited partnerships (LPs), and it would mean channelling financing from China into high-risk, scalable projects in Europe, a novel initiative with considerable room for growth.

Conversely, Europe is the recipient of a larger volume of investment in the energy sector than the United States. Investments in the energy sector comprise different types of assets: interests in public services companies, for example in Italy (CDP Reti) and Portugal (Energias de Portugal), wind farms in Germany (Meerwind), and even nuclear energy plants in the United Kingdom (Hinkley Point). This very notable presence reflects the aforementioned European receptiveness to Chinese investment in strategic sectors. Another sector where Europe looks more attractive than the United States is transportation and logistics. This reflects the fact that the European Union is China's first trading partner and is aligned with the expansion plans for the region as set out in the OBOR initiative. In the United States, joint transactions in the transportation and logistics sector amount to USD 175 million, whereas just COSCO's investment in the Port of Piraeus (Greece) substantially exceeds this volume. In addition to these transactions, other major deals have taken place in Spain (Port of Barcelona), Belgium (Zeebrugge Port terminal), the United Kingdom (Heathrow airport in London), Germany (Hahn airport) and Italy (port of Naples). Furthermore, although not a transaction specifically targeting infrastructure, the acquisition of the Irish aircraft leasing company Avolon by the HNA Group, valued at USD 7.6 billion, stands out.

In addition to the pattern of specialisation by sector, another of the basic differences between the pattern of Chinese investment in the European Union and that in the United States is that the former is more open than the latter regarding Chinese participation in public assets. In recent years, several corporate groups from China have begun to acquire part or full stakes in a large number of state-owned assets in Europe. It bears mentioning that in 2015 Chinese SOEs[19], which include companies specialising in energy and infrastructure, accounted for 70% of investment in the European Union, compared to 34% in the United States[20].

Another important difference related to the previous one is that investment transactions in which "national interests" might be involved are subject to approval by the Committee on Foreign Investment in the United States (CFIUS), a government committee set up in 1975 during Gerald Ford's term as President. This agency has no equivalent in Europe. This Committee reviews foreign investments in infrastructure, telecommunications, public healthcare, technology and other sensitive sectors. For example, in 2012, on the recommendation of the CFIUS, President Obama blocked the acquisition by Ralls Corp, a private Chinese group, of a wind turbine manufacturer in the state of Oregon. In 2005, also on the CFIUS's recommendation, Congress opposed the sale of Unocal (Union Oil Company of California) to the Chinese National Offshore Oil Corporation (CNOOC), even though the latter had submitted a higher bid. Unocal was finally sold to the Chevron Group.

In the absence of a committee equivalent to the CFIUS, Europe is seen by foreign companies as providing greater certainty and a more open framework for investment. Notably, in 2016 certain movements have taken place alerting against excessive Chinese investment in some European assets. For instance, President François Hollande warned of the increase in Jin Jiang Group's stake in Accor hotels, and Germany's Minister of Finance has called for protection for European technology.

One last difference between China's pattern of investment in the two regions is the relative weight of each type of transaction. In the United States, M&A transactions are more prevalent than they are in the European Union. Although Europe has provided the backdrop for a larger number of M&A transactions than the United States, transactions in the United States far exceed those carried out in Europe by value. In fact, in the 2010-2015 period 38% of transactions in the US involved M&A, compared to 62% for greenfield projects; whereas in Europe 75% of deals were M&A compared to 25% greenfield[21]. However, if we consider total investment volume in the United States, M&A accounts for 90% of total investment, with 10% in greenfield projects,[22] whereas in Europe the former amasses 82% of deals, compared to 18% in the case of greenfield projects. These differences suggest that Chinese companies are forced to make a larger investment when buying or acquiring stakes in US companies, which are, on average, larger than their European counterparts.

[19] Establishing a sharp distinction between public and private companies in China is very complex and difficult to do accurately. In principle, a distinction is usually made for companies that depend on the State Commission for supervision and administration of the 106 largest companies controlled by SASAC, the government agency that holds ownership stakes in many large Chinese companies. In actual fact, a large number of companies, despite being privatised, maintain formal or informal links with the government. Thus, any attempt at segmenting public and private concerns should be undertaken with caution.

[20] Data for the United States taken from Rhodium Group's China Investment Monitor

[21] Data for the United States taken from Rhodium Group's China Investment Monitor

[22] "Bird's Eye View: Comparing Chinese Investment into North America and Europe". Baker & McKenzie. 2016.

Box 2.

Catalonia: gateway to Europe

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In an increasingly interconnected world, a country's competitiveness is not directly proportionate to its size, but rather to the strategies it promotes to support innovation and internationalisation and to meet companies' needs. In this regard, low-population countries such as Sweden, Denmark and Finland are renowned worldwide for their competitiveness and for their full integration in the global economy. With a population similar to Denmark's and GDP and exports similar to Finland's, Catalonia is on a level playing field with these international benchmarks.

If we look closely at Catalonia, we find an enterprising region with an industrial base and a diversified economy, that is innovative and open to the world. In short, Catalonia offers value to the companies already operating there, as well as to firms that are considering setting up in Europe and those already based in Europe but looking for a second location or "second footprint". In all of these cases, Catalonia yields opportunities to connect China with the international markets and to provide Chinese companies with a highly competitive environment.

Competitive, industrial and diversified economy

Catalonia's entrepreneurial tradition has created a dynamic economy with almost 600,000 companies, most of which (99.8%) are small- or medium-sized. This entrepreneurship has historically been closely linked to industrial activity.

Catalonia is one of Europe's strongest industrial driving forces. At present, 20% of GDP is generated by industry (if industry-related services are also included, this proportion exceeds 50%). This figure positions Catalonia above the European average and already meets the objective set by the EU for 2020. However, we are faced with the challenge of reaching 25%, which will be closely linked to the development of industry 4.0 or the fourth industrial revolution, upon which Catalonia's industrial policy will revolve in the coming years in order to shape the future.

The Catalan business arena is highly diversified and although areas such as food, chemicals, and the automotive or pharmaceutical industries are very relevant, none of these sectors accounts for more than 15% of the industrial GVA. These companies also enjoy an offering of specialised and high added-value services in fields such as R&D, design, logistics, ICT and shared-service centres. In short, diversification and the presence of complete value chains, which include the manufacturing process and associated services, offer significant opportunities to foreign investors, who will be met with an extensive network of suppliers, partners and customers in Catalonia.

Investors will also find that Catalonia is fully integrated in the global economy. While Catalonia accounts for 0.1% of the world's population, it is responsible for 0.4% of the world's trade. Catalan exports rose by 6.1% in 2015 to over €63.8 billion, making it the sixth Eurozone economy in terms of growth rate.

This good performance in foreign markets is largely due to the business arena's commitment to innovation. According to the 2015 Catalonia Innovation Survey, over half of Catalan companies with more than nine employees (54%) carried out some type of innovation-related activity last year. The percentage increases significantly in the case of industrial companies (68%).

The survey also clearly shows that Catalan companies include innovation and internationalisation in their business strategy. In this regard, 57.2% of innovative companies made exports in 2015. Moreover, one in five Catalan companies (19%) forms part of the global value chains. These are companies that export and import regularly and have a strong innovation line of activity, as over 79.3% of them confirmed they had innovated in 2015.

Chinese investment in Catalonia

Catalonia is a very attractive region for foreign investment; the fact that over 6,450 foreign companies are located there is proof of this. Also, according to information from fDi Markets, in 2015 Catalonia was the leading region in Western Continental Europe and the fourth in all of Europe in terms of investment volumes received (approximately €5.2 billion).

The added value of these investments should also be noted, as Catalonia led the way in attracting R&D investment projects in Western Continental Europe in terms of the volume of investment and number of jobs created.

The outlook for the future is also positive. According to fDi's European Cities and Regions of the Future 2016/17 ranking, Catalonia is the best region in Southern Europe in which to invest in the next two years and Barcelona is the European city with the best strategy to attract investment.

In recent years, Catalonia and China have strengthened their relations, both at institutional level and through active presence and the development of joint activities with specific regions or benchmark financial players. This prompts an increasing number of companies to opt for Catalonia.

China has invested in various sectors in Catalonia and at different ends of the value chain, as is logical in such a diversified economy. Examples can be found in the form of companies from various sectors, such as industry (China National Bluestar Group or Huayi), technology (Lenovo or the Hong Kong company Cronos Telecom), logistics (COSCO or the Hong Kong-based Hutchison Whampoa), financial services (China Construction Bank), entertainment (acquisition of R. C.D. Espanyol by the chairman of Rastar) and distribution (Bright Food).

These operations also demonstrate the opportunities Catalonia has to offer in various types of investment. The examples listed include greenfield investments, joint ventures and successful merger and acquisition transactions with a long-term vision of the business relationship between Catalonia and China. Such is the case of the purchase of the biggest Catalan group in the distribution sector, Miquel Alimentació, by the Chinese food and distribution giant, Bright Food. This transaction has turned the Catalan group into a platform for the export of local products to China.

Investment by the China Certification & Inspection Group (CCIC) has also fostered the trade alliance between Catalonia and China. This state-owned certification company opted for Barcelona to set up a laboratory specialising in automotive products and certain consumer goods, such as machinery or toys. The Barcelona laboratory assures Catalonia's position as an export gateway to China.

A good indication of the performance of Chinese investment in Catalonia is the number of Chinese projects that have materialised through Catalonia Trade & Investment, a unit that specialises in attracting investment within ACCIÓ, a public agency of the Catalonia regional government that works to promote the competitiveness of Catalan businesses.

In 2015, China was the second country of origin (alongside France) of investment projects undertaken, and also in terms of investment volume. In particular, seven projects entailing investment of over €27 million were completed, far exceeding records for previous years.

Ideal ecosystem to attract Chinese investment

Chinese investment has expanded in recent years, but Catalonia still has the potential to attract a substantial portion of China's outbound FDI destined for Europe. This is true either in the case of a first establishment, which serves as an entry point not only to the European market but to the EMEA region as a whole and even as a bridge to Latin America, or for a second investment or "second footprint".

Catalonia's economic structure and ecosystem have all the elements necessary to make the region a hub for attracting Chinese investment. This ecosystem is underpinned by top-level infrastructure, a benchmark innovation system, a powerful ICT sector and good positioning in future areas such as e-commerce, among other factors.

• **Infrastructure and logistic strength**

Catalonia has a logistic vocation: its geostrategic location, network of transport infrastructure, consumption capacity and the structure of its business arena make it one of the main European hubs.

With its extensive connectivity network and its efficient logistics infrastructure, Catalonia's area of influence encompasses 400 million consumers who account for 60% of the European Union's GDP and who can be reached in 48 hours.

Connection with this area is facilitated by assets such as the Port of Barcelona, the biggest port in Spain in terms of the value of products imported and exported, and which hosts one of the most modern terminals in Europe, the Barcelona Europe South Terminal (BEST), operated by Hutchison Port Holdings. The Port of Tarragona, with its dock specialising in chemicals, is also noteworthy, as is Barcelona airport, with almost 200 worldwide destinations and excellent connections with Asia.

Barcelona is the only city in Southern Europe which has an international port and airport as well as road and rail links all within a 10-kilometre radius, making it an ideal hub for short- and long-distance distribution.

Where infrastructure is concerned, Catalonia emerges as the first-ranking logistics area of the Iberian Peninsula, with over 6 million m2 of constructed warehouses. It also has a diversified logistics arena thanks to the presence of global operators, e-commerce specialists and courier companies.

The value of all these assets is shown through the Barcelona China's European Logistics Center (BARCELOC) programme, a joint development of Catalonia Trade & Investment (Directorate-General of Industry - ACCIÓ), the Port of Barcelona and Barcelona City Council aimed at attracting production and distribution centres of Chinese and, in general, Asian industrial and logistics companies. Catalonia offers the best range of logistics services to distribute Chinese and Asian industrial products in the Iberian Peninsula, Southern Europe, North Africa, West Africa and Latin America.

• **Benchmark innovation and R&D system**

Catalonia is an innovative region, with an internationally recognised scientific and technical position. It generates 1% of global scientific output, ten times more than expected on the basis of its population. It boasts excellent scientific infrastructure, such as the Barcelona Biomedical Research Park, the Barcelona Supercomputing Center, home to the Mare Nostrum computer, the ALBA synchrotron, the Institute of Photonic Sciences (ICFO) and Idiada, one of the main suppliers of technological and testing services in the automotive sector worldwide.

It has industrial technology suppliers such as Eurecat, a large technological hub in Catalonia, which brings together centres of excellence in big data, advanced manufacturing, industrial robotics, water management, textile innovation and plastics processing. It also has entities accredited with the Tecnio seal, awarded to the developers and providers of the most innovative technologies.

A good example of the success of the Catalan innovation system are the results in raising European R&D funds, granted in competitive tendering processes. Since the commencement of the Horizon 2020 programme, Catalonia has received a total of €310 million, which accounts for 2.7% of the funds granted in the EU as a whole.

This favourable position opens doors for foreign investors, enabling them to find top-level partners in Catalonia to develop innovative proposals. It also helps them to find both consolidated companies and start-ups, affording them access to global markets, given the sound international performance of the Catalan business arena.

• ICT ecosystem: opportunity generator

ICT is one of the sectors that has grown the most in Catalonia in recent years, generating new activities and economic opportunities. One factor that has fostered its growth, particularly in terms of mobile communications, is Barcelona's position as Mobile World Capital until 2023 and the Mobile World Congress, the sector's biggest trade fair worldwide.

The Mobile World Congress is also a bridge between Catalonia and China in terms of liaison and technological cooperation, as shown by the high number of Chinese exhibitors at the last edition (174).

The relevance of Barcelona Tech City should also be noted; this initiative is open to all members of the digital and technological business ecosystem in Barcelona and its objective is to consolidate and strengthen this emerging sector and put Barcelona in a benchmark position on the international technological scene.

• Good e-commerce position

Closely linked to the aforementioned factors (logistics, infrastructure and the growth of the ICT sector), there is another contributing factor to the creation of an optimal ecosystem for Chinese investment, namely the potential of e-commerce and its ability to generate significant business for the logistics sector.

In 2015 the e-commerce market in Europe overtook the USA and China for the first time. This market is forecast to continue growing, particularly in Southern European countries, where spending per inhabitant is still less than in Northern Europe. Spain is the third market worldwide (after Russia and Brazil) for Aliexpress, Alibaba's international e-commerce sales portal, an indication of the potential of Spain and Catalonia.

Another market with great potential for e-commerce is the MENA region (Middle East and North Africa). Catalonia has the geographical position, the cultural proximity and the logistic strength necessary to serve these markets and meet customers' expectations; these aspects are at the heart of the e-commerce business model.

E-commerce needs a specific and advanced type of logistics that is scalable and able to respond to rapid growth. Logistics companies make intensive use of ICT and require easy access to sea, air and land transport to reach specialised areas for their activity.

These needs have been valued by the US multinational Amazon, which recently acquired 150,000 m2 of land to build a logistics centre. This investment attests to Catalonia's potential for e-commerce and for distribution in Southern Europe and North Africa.

A government on the side of Chinese investors

All of these elements make Catalonia an ideal location for Chinese investment, and this is one of the main lines of action of the Catalonia regional government, through ACCIÓ - Catalonia Trade & Investment. With this goal in mind, alliances have been formed with public and private agents, including ESADE, the Port of Barcelona, Barcelona City Council, and the regional governments of various Chinese provinces such as Guangdong and Jiangsu. Specific communications and promotion actions for China have also been set in motion, and a services offering has been tailor-made for Chinese companies.

We wish to be close to Chinese investors in order to ascertain their needs in the field, which is why we have had a direct presence in China since 1988. Catalonia currently has a network of 36 foreign trade and investment offices, three of which are located in China (Beijing, Shanghai and Hong Kong).

In short, the Catalonia regional government has the will and the capacity to accompany Chinese investment projects, regardless of type (greenfield, mergers and acquisitions, reinvestments, R&D investments, etc.), in order to maximise their possibility of success. Catalonia has all the elements necessary to connect Chinese companies with Europe and the Catalonia regional government wishes to be their main ally in achieving this.

3. China casts its eye on Southern Europe: investment in Italy, Spain, Portugal and Greece

The sharp increase in Chinese investment in Southern European countries can essentially be attributed to two factors, one of which is applicable to all of Europe whilst the other sets these economies apart. The first factor is the aforementioned upturn in Chinese investment across the continent as a whole, which is aimed at gaining a foothold in the largest consumer market in the world and seeking out assets that can help its companies compete at a global level. The factor unique to Southern Europe, however, is the opportunity presented to foreign investors in light of the economic crisis, the brunt of which has been borne by Southern European countries. Of particular interest to Chinese investors was the drop in asset prices, including the value of companies (both listed and unlisted), properties, offices, industrial land and labour. This scenario has afforded Chinese investors a greater knowledge of the potential of these countries, enabling them to identify new business opportunities.

In the years immediately following the Eurozone crisis, specifically 2015 and 2016, the economies of Southern Europe managed to overcome the recession and are once again in a new growth cycle, despite ongoing challenges and room for improvement. Italy, the fourth European economy, grew by 0.8% in 2015, its sharpest increase in the last six years; Spain advanced by 3.2% and presented the largest growth of all the major European economies; Portugal reported growth of 1.5%, its best since 2010; and whilst Greece shrank by 0.2%, this negative growth was far removed from the 9.1% drop in GDP witnessed in 2011. Nevertheless, in the majority of these countries, the recovery in economic growth has yet to bring about the same level of foreign investment as that received in 2010. Based on UNCTAD data, foreign investment stock in these four countries in 2015 was lower than in 2010 with the exception of Italy, where it has remained practically level[23].

Against this backdrop, China is one of the countries leading the charge in terms of investment in Southern Europe, countering the sluggishness shown by other international investors, and is one of the main sources of foreign capital for these economies. Southern European countries stand out as one of the main targets of Chinese firms when they look to Europe with a view to widening the exposure of their portfolios to this region, accessing new customer groups or fully or partially acquiring an industrial company. This group of countries received investment totalling USD 370 million in 2010, 11.8% of the total for Europe, whilst the cumulative volume of investments had multiplied by 2015 to exceed USD 25 billion, or 28.3% of the total (cumulative Chinese investment in the 2010-2015 period).

Why are Chinese investors interested in Southern European countries?

In order to answer this question, a distinction must be drawn between each country, as the pattern and nature of Chinese capital differ in Italy, Spain, Portugal and Greece. Italy attracts the most complex Chinese investment, encompassing an extensive range of transactions and economic sectors. Spain was the last major European economy to receive Chinese funds, although a second wave of greater investment in a large number of sectors has already begun. In the case of Portugal, which enjoyed a rush of Chinese investment (2011-14) under its privatisation plan, investor interest was reaffirmed in 2015 with the consolidation of the investments already made and the entry of new players attracted by both the public sector and private companies. Chinese investments in Greece have been concentrated in a promising transaction with considerable strategic implications: the COSCO Shipping Group's bid for the Port of Piraeus. The pattern of investment in each of these four countries and the main transactions carried out are examined below.

[23] Moreover, the proportion of investment in the four countries analysed is reduced if weighted by the size of their economies: the four countries represent 21% of the European economy, but their weight as a percentage of the total foreign investment channelled into the region as a whole is 12.8%. Of the four countries analysed, only Spain and Portugal have received foreign investment commensurate with the size of their economy, whilst investment in Italy and Greece has been proportionately below their GDP.

3.1. Italy, a key destination for investment by Chinese firms

Chinese companies have been drawn to Italy, one of the main targets of Chinese investment in Europe, since the FDI doors began to open. The first transactions took place in the early 1980s when small representative offices were set up to conduct trading activities, as in the cases of Bank of China in Milan and Nanjing Motor Corporation in Turin. Chinese investment in Italy has since continued to grow, especially after the turn of the century, with increasingly complex investments encompassing a wider range of economic sectors[24]. Today Italy is the second recipient of Chinese FDI in Europe in terms of cumulative investment (2010-15) according to the ESADE China Europe database, with an estimated USD 15.01 billion channelled into Italy by China. Towards the end of this period a total of 417 Italian companies were partly owned by Chinese firms (313 by companies located in mainland China and 104 by Hong Kong-based firms) employing 22,800 workers, according to "Fondazione Italia Cina" data.

For Chinese investors, Italy is not only the fourth largest economy in Europe with a market of close to 60 million consumers, it also offers a wide range of sectors of significant interest, from internationally renowned agribusiness products, to highly specialised industrial business clusters, as well as premium brands in the luxury goods sector and low-risk strategic assets, such as those used in the energy sector. China also perceives Italy as having a highly qualified workforce that is closely linked to its industrial sector, and it is the Southern European country in which Chinese firms have concentrated their investment in R&D centres.

To date, Chinese investment in Italy has mainly centred on the manufacturing sector (in the form of company acquisitions and the start-up of industry-applied R&D centres) and the energy sector, although notable transactions have also been carried out in other areas of activity.

Industrial investment conforms to a pattern already observed in other European countries: acquisition of a minority or majority shareholding in a company that is highly specialised – typically in a product with major growth potential in China – so as to access its know-how and technology. A notable example of this strategy was the acquisition of CIFA (Compagnia Italiana Forme Acciaio SpA), an industrial cranes and cement production specialist, by the Chinese construction and engineering company Zoomlion Heavy Industry (60%) and the investment funds Hony Capital, Mandarin Capital Partners and Goldman Sachs (40%) in 2008. The transaction, at the time the largest ever acquisition of an Italian industrial company by a Chinese company, was aimed at creating the leading property construction group in the world and improving the Chinese firm's production capacity so as to increase its presence in the local and international markets. More recently, in 2015, Zoomlion and the fund Mandarin Capital acquired a 75% stake in Ladurner, a family business engaged in environmental technology, for USD 73 million. This acquisition was carried out as a means of gaining direct access to technological know-how in the environmental segment, with the aim of competing in the domestic market, in a country with an urgent need for environmental solutions.

The largest transaction by a Chinese firm in Italy – and indeed Europe – to date also arose in the industrial sector, namely the USD 8.9 billion acquisition of Pirelli & C. SpA, the fifth largest tyre manufacturer in the world, by China National Chemical Corp (ChemChina). Through this transaction, the Chinese firm intends to supply tyres to the leading automobile manufacturers in its home country, at a time of intense demand for high-end automobiles and electric vehicles. Although the decision-making centre will initially remain in Italy, certain activities relating to the design and development of new models could potentially be relocated to Pirelli's plant in Yanzhou, China.

Mention should be made of the investment channelled into R&D centres to develop innovative industrial products, such as home appliances and automobiles[25]. By way of example, Huawei has up to four R&D centres in Italy that employ a total of 100 workers, including most notably the "Centro Globale di Competenza Microwave di Milano", an advanced centre for the development of the latest generation of microwaves. In the automobile sector, in which Italy has a long industrial tradition especially in terms of design, Chinese firms have set up various centres to develop new products. Notable examples include Changan, which established its European Design Centre in Turin in 2006, its first R&D centre outside of China; Anhui Janghuai, another car manufacturer, which set up its JAC-Italy Design Center in Turin in 2007; and Keewaymotor, a motorcycle manufacturer that also owns the Benelli brand, which chose Pesaro (Italy) for the location of one of its R&D centres.

The overall strategy behind investments in the energy sector differs to that employed for transactions carried out in industrial sectors. The former mostly comprise partial purchases of state-owned assets with a predictable and stable expected return, wherein the investors have little or no intention of ta-

[24] Carlo Pietrobelli, Roberta Rabelloti and Marco Sanfilippo. "Chinese FDI strategy in Italy: the "Marco Polo" effect" Int. J. of Technological Learning, Innovation and Development, Vol. 4, No. 4, 2011

[25] Marco Sanfilippo. "Chinese investments in Italy: Facing risks and engaging opportunities", Istituto Affari Internazionali (2014)

king control of their management. The highest-volume operation was that carried out by State Grid Corporation of China, the biggest electricity company in the world, in its purchase of a 35% stake in the state-owned electricity company CDP Reti for USD 2.81 billion. The transaction, finalised in 2014, is the largest carried out by the Chinese firm outside of its borders, and the greatest purchase of state-owned assets in Italy to date. During that year Fondo Strategico Italiano (a holding company 80% owned by Cassa Depositi e Prestiti and 20% owned by Banca d'Italia) reached an agreement with the Chinese firm Shanghai Electric for the sale of a 40% interest in the electricity company Ansaldo Energia. The companies also agreed to create two joint ventures in order to set up a shared R&D centre and to jointly manufacture gas turbines for the Asian market. Moreover, the People's Bank of China (PBC), the country's central bank, took respective holdings of 2.071% and 2.102% in the oil and gas company ENI (Ente Nazionale Idrocarburi) and the electricity company ENEL (Ente Nazionale per l'Energia Elettrica), two state-owned energy groups and the two largest Italian companies by market capitalisation. In both cases, the Chinese bank's holding is merely symbolic, lagging considerably behind those of other private or institutional foreign investors.

Although Chinese investment in Italy has centred on the industrial and energy sectors, for which a clear investor pattern can be discerned, Chinese companies have also invested in other sectors, such as finance, infrastructure, luxury goods and football. In the financial sector, the transactions performed to date have been notable in terms of the minority holdings involved, with investors aspiring to be passive shareholders rather than to gain control. The People's Bank of China has gradually accumulated a 2.014% holding in the insurance company Assicurazioni Generali, a 2.001% interest in Mediobanca, a 2.005% stake in UniCredit and a 2.010% holding in MPS (Monte dei Paschi di Siena), in addition to various other minority interests in the financial and energy sectors. As regards infrastructure, mirroring events in other European countries such as France or Greece, Chinese infrastructure and logistics firms are channelling investment into Italy in order to improve and expand their commercial capacity. Examples of this strategy include the investments made by COSCO in the Port of Naples, by China Shipping Company in the Port of Genoa and by IZP, a logistics and e-commerce firm, in Parma airport. These projects could convert such infrastructure into points of entry for Chinese products into Europe under the OBOR initiative.

Aside from these business acquisitions, we should also highlight the purchase by the private group Fosun of the UniCredit group's former headquarters at the Palazzo Broggi in Milan, valued at USD 381 million, in one of the largest real estate operations carried out in Europe last year.

Table 2 The 10 largest investments by Chinese firms in Italy (2010-2016)

	YEAR	ACQUIREE	BUYER	VALUE ($ MILLION)	SECTOR
1	2015	Pirelli & C SpA	China National Chemical Corp - ChemChina	8,982	Manufacturing
2	2014	CDP RETI	State Grid Corp of China	2,811	Energy
3	2015	UniCredit	People's Bank of China	804	Financial
4	2016	AC Milan	Alibaba	765	Sports
5	2015	Assicurazioni Generali	People's Bank of China	570	Financial
6	2014	Ansaldo Energia	Shanghai Electric	560	Energy
7	2012	Ferretti	Shandong Heavy Industry	460	Manufacturing
8	2014	Palazzo Broggi	Fosun International Ltd	381	Real estate
9	2016	Inter	Suning	295	Sports
10	2008	Compagnia Italiana Forme Acciaio	Zoomlion	264	Manufacturing

Source: ESADE China Europe database

In the luxury goods sector, the Chinese retail distributor Trinity took control of Cerruti in 2011, whilst the Weichai Group acquired yacht maker Ferretti in 2012. These transactions reflect a strategy to access exclusive brands positioned in the high purchasing power segment so as to meet the growing demand for these products from Chinese consumers.

Following a pattern already seen in other major European football leagues, during the year the Chinese electronics goods specialist Suning acquired a 70% stake in Inter Milan for €270 million[26] (USD 295 million). Suning also owns the largest club of its province, Jiangsu Suning, and has previously signed sponsorship agreements with FC Barcelona and Liverpool. The purchase of a 70% stake in the historic team AC Milan by e-commerce giant Alibaba for €700 million (USD 765 million), scheduled for completion towards the end of the first half of 2016, is also significant. Jack Ma, chairman of Alibaba and the second richest man in China, already has a presence in the world of football as the owner of Guangzhou Evergrande Taobao, one of the top clubs in the Chinese Super League.

In conclusion, ownership of leading Italian companies associated with the "Made in Italy" brand has gradually been globalised in recent years. Other than the companies referred to which have been wholly or partially acquired by Chinese firms, many other firms with a long industrial tradition have recently opened up to foreign capital. For example, a 25% interest in Alitalia was sold to the French-Dutch group Air France-KLM in 2009, whilst Pininfarina, a design company of reference in the automotive sector, was sold to the Indian group Mahindra in 2015.

Nevertheless, these acquisitions have not resulted in the Italian government adopting a greater protectionist stance. On the contrary, the Italian administration has proven to be a partisan of globalisation and competition, and has even encouraged state-owned enterprises to be more open to foreign capital through the "Fondo Strategico Italiano". For as long as the private sector is willing to sell companies and the public sector is open to foreign capital, Italy will remain a highly attractive option for Chinese investors. According to the "Fondazione Italia Cina", the sectors that will present opportunities for greater Chinese investment in the coming years are energy efficiency and environmental protection, information technology, biotechnology, advanced machinery production, alternative energies, new materials and ecological vehicles. The Italian government hopes to increase the weight of these sectors from 5% of GDP in 2010 to 15% in 2020.

3.2. Spain, the last great conquest of Chinese firms in Europe

Although Chinese investment in Spain is a recent phenomenon, having arrived later than in other major European economies such as the United Kingdom, France, Germany or Italy, it has grown exponentially in recent years. China's cumulative investment in Spain since 2010 stood at just over USD 2 billion in late 2015 and annual investment for that year alone exceeded the amount received in the five previous years (2010-2014). Cumulative investment rose from USD 920 million in late 2014 to USD 2.05 billion at the end of 2015, pushing Spain up two places in a single year among the main countries of the European Union receiving investment[27]. However, Spain is still some way off receiving the more than USD 15.01 billion invested in Italy or the USD 7.23 billion channelled into Portugal during the same period (2010-2015). Nevertheless, although Spain continues to lag behind the other main European countries, and despite the negative experience of the Wanda Group, the data indicate a potential future second wave of Chinese investment into the country, which could foster greater investment than that witnessed to date.

Despite having virtually no operations until recently, numerous Chinese companies have set up in Spain for the first time. Based on data from the ESADE China Europe Observatory[28], a total of 96 Chinese companies currently operate in the country (see table 3) compared with the 74 identified by this Observatory a year ago. Many leading public and private Chinese companies have renewed their focus on Spain in recent years, such as the technology companies Huawei, ZTE and Lenovo; the household appliance multinational Haier; major companies in the logistics sector such as COSCO, China Shipping and Kerry Logistics; the banks CCB[29] and ICBC[30]; as well as other multinationals such as Air China and Keewaymotor.

Despite the political uncertainty making its mark on the current scenario, both at national level and in certain autonomous regions, 2016 is expected to be a year of growth for both established companies and new arrivals, the latter of which include Aviation Industry Corporation of China (AVIC), a manufacturer for the aeronautics sector, and Shanghai Kaichuang, a food company which entered the Spanish market by acquiring local firms.

Spain presents three distinguishing features as regards Chinese investment, which it either shares with other European countries or which set it apart. Firstly, foreign investors have been able to take advantage of the opportunities that have arisen as a result of the economic crisis. However, Spain has not witnessed any major sell-offs of state-owned assets in any sector considered strategic. Although firms were approached and interest was expressed, such as in the case of the Chinese State Grid vis-à-vis the distributor Red Eléctrica de Es-

[26] http://deportes.elpais.com/deportes/2016/06/06/actualidad/1465200422_637633.html

[27] Spain rose from 11th to 9th place in terms of cumulative investment. See ESADE report Chinese investment in Europe (2015)

[28] The Observatory that monitors the presence of Chinese businesses in Spain also monitors firms from Hong Kong

[29] China Construction Bank

[30] Industrial and Commercial Bank of China

paña (REE)[31], or the conglomerate Fosun with respect to the public-private insurance company CESCE[32], none of these agreements ultimately came to fruition. The first transaction in the energy sector, valued at €1.25 billion[33] (USD 1.37 billion), was carried out in 2015 and comprised the purchase of Madrileña Red de Gas[34] by the Dutch pension fund PGGM, the Chinese group Gingko Tree Investment, the Chinese investment arm of SAFE and the French firm EDF Invest[35]. The Chinese fund SAFE's participation in the purchase has been valued at USD 730 million, China's biggest investment in Spain to date. In April 2016, the UK-based Lancashire County Pension Fund (LCPF) joined these owners by purchasing an indirect 12.5% holding in the distributor Madrileña Red de Gas (MRG), thereby contributing to the expansion of the business[36].

Infrastructure has proven to be another strategic sector, although only one major transaction has been carried out to date: the investment made by the Hutchison Whampoa Group[37] (Hong Kong) in the Port of Barcelona terminal in 2008, which stands at a total of €580 million (USD 633.5 million)[38]. In 2015 the Port of Barcelona extended the concession to Hutchison for a further 15 years, reaffirming this large Hong Kong group's commitment to Spain and putting the country on the map of potential partners within the OBOR initiative. There has also been a large number of smaller operations that are of huge strategic value in fostering bilateral trade and investment between China and Spain, such as the opening of the certification laboratory by the China Certification Inspection Group (CCIG) at the Port of Barcelona.

Secondly, the leadership position enjoyed by numerous Spanish companies in Latin America and their presence across the rest of Europe have lured investment and fostered strategic alliances between Chinese and Spanish companies. For instance, in its rivalry with América Móvil (owned by Mexican Carlos Slim) for leadership in the Latin American telecommunications market, the Spanish firm Telefónica has an interlocking shareholding with China Unicom through which numerous common projects have been developed, such as the joint venture Smart Steps Digital Technology Company Limited[39] (55% held by China Unicom and 45% by Telefónica) created recently to provide big data services in China. Other Chinese technology giants, such as Huawei and ZTE, are also working with the Spanish firm on several joint projects in Latin America. The collaboration with Huawei has focused on digital home services in Latin America[40] whilst one of the latest collaboration projects with ZTE has been to roll out a VoIP system in Peru[41]. Beyond telecommunications, there has also been activity in the oil sector. In 2010 the oil giant China Petroleum & Chemical Corporation (Sinopec) acquired a 40% interest in the Spanish company Repsol in Brazil by subscribing the entire capital increase of USD 7.1 billion. This incoming Chinese capital is aimed at securing the oil giant's stake in the joint exploration of the oil fields in the areas of Guará and Carioca. Sinopec continued to buy shares in other European companies, such as GALP in Portugal, facilitated by cooperation agreements signed between Brazil and China[42].

Thirdly, Chinese companies have shown particular interest in the Spanish agribusiness sector, where a greater number of large transactions have taken place than in other European countries. In 2014, the Fosun Group acquired a 20% holding in Osborne, the food and beverages company, although this stake is currently under sale[43]. In 2015 the Bright Food Group, which specialises in food distribution and had already acquired a UK food company, purchased the entire share capital of the Catalan company Miquel Alimentació for €110 million (USD 120 million), in the fifth largest transaction carried out in Spain. Through this operation Bright Food hopes to become the main Chinese importer of Spanish food brands, starting with the contract to distribute Codorníu sparkling wines in China, while simultaneously creating a platform for global distribution using the distribution network established by Miquel Alimentació[44]. Another operation in the agribusiness sector was the purchase by Changyu Pioneer Wine (the leading wine producer in China) of a 75% stake in the Navarrese winery Marqués de Atrio for €35 million (USD 38 million) in 2015.

31 See: http://www.elmundo.es/elmundo/2012/07/01/economia/1341170651.html
32 See: http://www.elconfidencial.com/empresas/2015-04-08/la-irrupcion-del-fondo-chino-fosun-pone-en-jaque-la-privatizacion-de-cesce_755102/
33 The Company has debt of €755 million (USD 824.7 million) which has been assumed by the buyers
34 http://economia.elpais.com/economia/2015/04/22/actualidad/1429685724_267114.html
35 http://www.europapress.es/economia/noticia-morgan-stanley-vende-madrilena-red-gas-edf-gingko-tree-pggm-20150422181928.html
36 http://www.cuatrecasas.com/es/actualidad/notas_prensa/cuatrecasas_asesora_a_lancashire_fund_en_la_adquisicion_del_125_de_madrilena_red_de_gas.html
37 The value of this investment is not included in the USD 2.05 billion cumulative investment in Spain during 2010-15 as the database does not include investments from Hong Kong companies in any of the countries included in this study.
38 http://www.lavanguardia.com/20150924/54435447546/el-puerto-de-barcelona-amplia-la-concesion-de-hutchinson-15-anos-eduardo-magallon.html
39 https://www.telefonica.com/documents/23283/4482359/NdP_TEF_CU_Smart_Steps.pdf/343f3978-742a-4281-af2e-a1bf24a12899?version=1.0
40 https://www.telefonica.com/es/web/sala-de-prensa/-/telefonica-y-huawei-impulsaran-juntas-los-servicios-de-hogar-digital-en-latinoamerica
41 http://www.eleconomista.es/empresas-finanzas/noticias/7651645/06/16/ZTE-y-Telefonica-construyen-la-primera-red-comercial-VoLTE-FMC-IMS-en-Peru-y-para-Telefonica-Latinoamerica.html
42 https://actualidad.rt.com/actualidad/192245-china-inversiones-proyectos-america-latina
43 See: http://economia.elpais.com/economia/2016/07/11/actualidad/1468242358_411828.html
44 http://cincodias.com/cincodias/2015/09/30/empresas/1443611253_471821.html

Table 3

Chinese companies with a presence in Spain (2016)

COMPANY	SECTOR
3E Henming S.L.	Renewable energies
Xinhua News Agency	Communications
Air China Limited Sucursal en España	Air transport
Air Sea Worldwide Spain S.L.	Transportation and logistics
ANSTEEL Spain S.L.	Steel and other materials
ANTAI Trading S.L.	Tourism - Hotels
Aranda Coated Solutions	Metals and metallurgy
Aviation Industry Corp of China AVIC (Aritex Cading S.A. 95%)	Manufacturing
BAOSTEEL España S.L.	Steel and other materials
Bluestar Siliconas España S.A.	Chemicals
Bright Food (Group) CO. (Miquel Alimentació 100%)	Food and beverages
Burwill Holdings Ltd.	Trade and steel
BYD España	Electric vehicles
Candy Novelty Works (Au'some CANDIES EUROPE S.L. (HK))	Food and beverages
Cathay Pacific Airways (HK)	Air transport
CCS China Classification Society	Corporate services
Changyu Pioneer (Marqués del Atrio 75%)	Food and beverages
China Certification Inspection Group Co Ltd Sucursal en España	Corporate services
China Construction Bank (Europe) S.A. Spanish Branch	Financial
China National Fisheries Company	Food and beverages
China Shipping Spain Agency S.L.	Transportation and logistics
China Unicom (Smart Steps Digital Technology Co., Ltd. 55%)	Telecommunications
CHINT Energy S.L.U.	Electrical materials
Chongqing Kangde Industrial (Group) Co., Ltd.(Hotel Barceló Santiago - Canarias)	Tourism - Hotels
Citic HIC Gandara Censa S.A.U.	Materials and metallurgy
CITS China International Travel Service Ltd.	Tourism
CNCC China National Chemical Corporation	Chemicals
COSCO Iberia S.A.	Transportation and logistics
CRONOS Telecom (HK)	Telecommunications
CROWN Relocations (HK)	Transportation and logistics
CZICC China Zhenjiang International Economic	Construction
DALIAN WANDA Group (Club Atlético de Madrid 20%)	Real estate and sports
Daxiong Spain S.L.U.	Metal products
DHZ Creative Production	Culture and leisure industry
Down Galaxy International Ltd (Ilion Studios SA)	Culture and leisure industry
ELAI Cultural SL.	Tourism and culture
Elkem Iberia SL (ChemChina Group)	Renewable energies
ESPRIT Holding LTD	Fashion
Fidelidade	Insurance
Fosun Group (Osborne 20%)	Food and beverages
GIGABYTE Technology España SL	Telecommunications
Goldbridge Bruder S.A.	Automobile accessories
Grand View Container Trading	Transportation and logistics
GREE Spain Corporation S.L.	Air conditioning equipment
Haier Europe Trading S.R.L. Sucursal en España	Electrical appliances
Hebei Iron and Steel Group (DUFERCO ESPAÑA S.L.)	Metallurgy
HISENSE Electronic Iberia S.L.	Electrical appliances
HISOFT	Telecommunications
HNA Group (29.5% of NH Hoteles)	Tourism - Hotels

COMPANY	SECTOR
Huawei Technologies España, S.L.	Telecommunications
Huayi Compressor Barcelona S.L.	Components for equipment
Hutchison Whampoa Group (HK)	Transportation and logistics
Industrial and Commercial Bank of China (Europa) S.A. Sucursal en España	Financial services
Jiangsu GPRO Group Co., Ltd. (Hotel Valparaíso Palace & Spa)	Tourism - Hotels
Jiangsu Sunrain Solar Energy Co., Ltd.	Renewable energies
Jinko Solar	Renewable energies
Keewaymotor España, S.L.	Automotive
Kerry Logistics	Transportation and logistics
King & Wood Mallesons SJ Berwin (HK)	Legal services
LEE'S Food Ibérica SL	Food and beverages
Lenovo Iberia	Telecommunications
Link International Sports (Granada CF)	Sports industry
LOUVRE HOTELS ESPAÑA SL (Jin Jiang Group)	Tourism - Hotels
Madrileña Red de Gas (Gingko Tree Investment SAFE)	Energy
Mandarin Oriental Hotel Group (HK)	Tourism - Hotels
Maxchief Investments Ltd.	Industrial furniture
Melcol Property	Tourism and leisure
Midea Europa	Electrical appliances
MINDRAY Medical España SL	Medical devices
Minmetals España S.L.U.	Metallic materials
MOTIC Spain S.L.U.	Medical devices
OP-POWER	Renewable energies
Nanfang Pump Industry	Materials and equipment
Rastar Group (El Espanyol 85%)	Toys and leisure
Sanhua International Europe S.L.	Electronic components
SANY European Machinery S.L.	Construction machinery
Shanghai Greenland Shenhua F.C. (Licence for Club de Fútbol Cracks)	Sports industry
Shanghai Kaichuang Ltd) (Hijos de Carlos Albo SL)	Food and beverages
Shandong Heavy Industry Group (Ferretti)	Maritime equipment
Shuanghui Group (CAMPOFRÍO)	Food and beverages
SINOCHEM España	Petrochemicals
SINOVEL WIND Spain S.L.	Renewable energies
SIU FASHION S.L. (Neo Concept Group)	Fashion
SOLARFUN POWER Holdings Ltd	Renewable energies
SUNFOR LIGHT S.L.	Lighting materials
TP-LINK Technologies Co., Ltd.	Technology
TRINA SOLAR	Renewable energies
VERDINIA Garden SL (Hispano-Chinese JV)	Architecture and engineering
Vita Green Europa S.A.	Pharmaceuticals
Wuhan Double Co Ltd (Media Base Sports SL 46% - (Desports)	Culture and sports industry
Wuxi Suntech Power Co., Ltd.	Renewable energies
YINGKE ADARVE Law Firm	Legal services
YINGLI Green Energy Spain S.L.U.	Renewable energies
Yiwubuy.com	e-commerce
Zhejiang Chimin Pharmaceutical Co Ltd (Linear Chemicals SL)	Pharmaceutical industry
ZOPO Shenzhen ZOPO Communications-equipment Limited	Telecommunications
ZPMC Shanghai Zhenhua Heavy Industry Co., Ltd.	Machinery and equipment
ZTE Corporation Sucursal en España	Telecommunications

Source: ESADE China Europe Observatory (June 2016)

Acquisitions in the agribusiness sector have continued throughout 2016. Shanghai Kaichuang concluded the purchase of Grupo Albo, a canning company based in Galicia, for €61 million (USD 67 million). This operation forms part of the Chinese firm's strategy to gain a share in third markets in which the Spanish firm has a significant commercial presence, such as Europe, Latin America and Africa. Lastly, the web portal Alibaba recently met with the Spanish Food and Beverages Federation (FIAB) to discuss the inclusion of Spanish food products in its portfolio[45].

In recent years Chinese firms have looked beyond the agrifood sector to open up to new areas, culminating in noteworthy transactions. In 2013, in the midst of the Chinese outbound tourism boom, the HNA Group began to purchase stakes in Spanish hotel chain NH, and currently holds a 29.5% interest in its capital. The transaction not only granted the Chinese group access to the world's second-ranking country in terms of inbound tourists, but also to the hotel network and management expertise of a successful and highly internationalised group such as NH. For the Spanish chain, in addition to the capital inflow, the entry of the Chinese shareholder facilitated its launch into the Asian country's complex tourism sector through the incorporation of a joint venture – HNA-NH Hotel Management Joint Venture Company – in 2014. Despite certain recent management tensions, the CEO of NH Hotel Group has highlighted the group's positive outlook for 2016[46], forecasting EBITDA of €190 million (USD 207.5 million).

In 2016 China Aviation Industry Corporation (AVIC) acquired a 95% interest in Aritex Cading from the Catalan company Comsa Corporación for USD 56 million. Aritex Cading, also based in Catalonia, specialises in the supply of automatic assembly systems for the aeronautical and automotive sectors. Its clients include Airbus, Mercedes and Volkswagen and it also has a production plant in Latin America. This business acquisition was the first of its kind in the specialist technology industrial sector in Spain. Such operations had until then been seen in Northern European countries, especially Germany. In the technological area, JTSI, a Chinese fund quoted on the Shenzhen stock exchange, has recently announced its purchase of the Spanish engineering company Eptisa from the fund Magnum Capital Industrial Partners through the subscription of a share capital increase of USD 17.5 million. Another notable transaction, in this case in the industrial sector, was the acquisition of Gándara Censa, a boiler works firm specialising in mining mills, by the conglomerate CITIC for USD 61 million in 2010. Following the acquisition, the Chinese firm invested USD 22 million in a new industrial bay and machinery to expand the Spanish company's production capacity and fully consolidate its own presence in international markets.

Table 4 The 10 largest investments by Chinese firms in Spain (2010-2016)

	YEAR	ACQUIREE	BUYER	VALUE ($ MILLION)	SECTOR
1	2015	Madrileña Red Gas	Gingko Tree Invest. (SAFE)	730	Energy
2	2014	Edificio España	Dalian Wanda Group	369	Real estate
3	2013	NH Hoteles	HNA	306	Tourism
4	2016	RCD Espanyol	Rastar	137	Sports
5	2015	Miquel Alimentació	Bright Food	120	Agribusiness
6	2016	Hijos de Albo	Shanghai Kaichuang	69	Agribusiness
7	2015	Melco Property	MelcoLot	65	Real estate
8	2010	Gándara Censa	CITIC Group	63	Industrial
9	2014	Club Atlético Madrid	Dalian Wanda Group	61	Sports
10	2016	Aritex Cading	AVIC	56	Industrial

Source: ESADE China Europe database

[45] See: http://cincodias.com/cincodias/2016/07/04/empresas/1467640429_039246.html
[46] http://economia.elpais.com/economia/2016/06/21/actualidad/1466524228_331038.html
[47] See: http://ccaa.elpais.com/ccaa/2016/07/20/madrid/1469002712_874509.html
[48] http://www.expansion.com/catalunya/2015/11/02/56375e8cca4741fd528b45e1.html

The only notable transaction to date in the real estate sector has been the purchase of the Edificio España building by the Dalian Wanda Group for €368 million (USD 403 million) in 2014. This central-Madrid asset had been unoccupied for a number of years, and Dalian Wanda intended to refurbish and convert it into a hotel and business apartments. The operation encountered certain problems relating to permits for the restoration works and the property was ultimately sold on to a private Spanish investor in summer 2016 for a higher amount that initially paid, generating gains for the Chinese investor[47]. Dalian Wanda also continues to hold its 20% stake in the share capital of Club Atlético de Madrid, which it acquired for USD 49.3 million.

Turning to the sports sector, which has been the target of major investment in various European countries in recent years, the Chinese electronic toys and video game firm, Rastar, acquired a 40% stake in Real Club Deportivo Espanyol de Barcelona for €65 million[48] (USD 71 million) in 2015. The Rastar Group increased its holding to 85% for a total value of USD 137 million in 2016 and is expected to acquire further interests before year end.

To summarise, although Spain was the last major European economy to receive Chinese funds, once Chinese companies had become established in the country, they showed great interest in exploring new opportunities. Despite close to 100 Chinese companies currently operating in the country, Spain has yet to see any investments of the magnitude witnessed in Germany, France, Italy, Portugal and Ireland. Spain has one of the widest growth margins amongst European countries due to its potential and the business opportunities presented in various sectors such as tourism, real estate, logistics, agri-food and the industrial sector. As a result, the Chinese conquest of Spain is expected to continue to gather pace over the coming years.

Box 3.

Barcelona, the Mediterranean logistics centre for Chinese investors looking to do business in Europe

Author: Barcelona City Council. Enterprise, culture and innovation division. City development department

China is the second largest economy in the world and has the potential to overtake the United States. Its economy has undergone annual double digit growth for two decades. Despite its growth having slowed to "just" 7%, China continues to act as the world's factory and as an industrial engine that drives the global economy, making progress in cutting-edge and technological sectors.

What's more, given the rising maturity of its domestic economy, China is promoting the internationalisation of its businesses and investment in foreign markets. According to a recent report from Baker & McKenzie, Chinese investors ploughed a record USD 40 billion into Europe and North America in 2015, of which 70% flowed into four sectors: tourism, automotive, financial services and information technology.

Barcelona, a magnet for investment projects

In the past two years, the general trend has been for China's investments to increase through mergers or the acquisition of Spanish companies. Recent examples include the 2015 acquisition of Miquel Alimentació by Shanghai Bright Food Group, and the purchase of Aritex (aeronautics and automobile sector) by AVIC, Aviation Industry Corporation of China, at the start of 2016.

Another notable project is the establishment of a European base for the industrial laboratory China Certification and Inspection Group (CCIC), a European inspection and certification company for industrial products being exported to China. This greenfield FDI project was set up in Barcelona at the start of 2015 and is key to enabling local and European companies to sell their products in China with the "CC" certification awarded by the "laboratory" in Barcelona. This centre currently certifies automobile parts but will soon be extending its activity to leather goods and, further down the line, to the agri-food sector.

Additionally, Barcelona is working on other investment projects in sectors such as shared services and e-commerce, where it has an extensive ecosystem of technological companies and the capacity to attract international talent with language skills and experience. Barcelona is a magnet for international talent in the form of people seeking to enjoy the quality of life, the cultural offering and the professional opportunities provided by the city, who in turn bring their cultural and linguistic diversity and professional experience. When combined, the new arrivals and the local citizens make up a very attractive offering of talent for foreign companies and contribute positively to the enrichment of an already vibrant business ecosystem.

Barcelona, a logistics hub

Barcelona is undoubtedly a major logistics centre for the Mediterranean and Southern Europe. The Port of Barcelona offers services such as handling, warehousing and preparation of goods for dispatch to their final destination.

Other advantages are short-distance delivery to the Mediterranean area and North African market and, most importantly, access to local industrial sectors such as automotive, chemicals, textiles and the agri-food business in the metropolitan area of Barcelona, as well as the rest of the Euro-Mediterranean market. The city council has therefore joined the "BARCELOC" initiative being pushed by the regional government of Catalonia and the Port of Barcelona to promote Barcelona as a logistics hub in the Mediterranean and a gateway to Southern Europe for Chinese companies and investors.

China, an important market for Barcelona

The Chinese market is a priority for Barcelona. Eleven years ago, Barcelona City Council, through the city development department, was the first public authority to create a "China Desk" manned by a Mandarin-speaker familiar with Chinese culture and customs. This is fundamental so as to facilitate communications with Chinese business owners wishing to do business or invest in the city. A key objective of the China Desk is to handle potential investment projects and assist with their smooth integration into the city, as well as to provide adequate monitoring services to Chinese companies established in Barcelona.

In addition to assisting potential Chinese investors visiting the city, it is also important to establish a presence in the Chinese market. To this end, Barcelona City Council also organises events in China to promote Barcelona as a business centre for Southern Europe and the Mediterranean.

The information technology and communications sectors have two key areas in their sights: Shenzhen and Shanghai. We have participated in the last eight editions of the largest technology fair in China – the Hi-Tech Fair in Shenzhen. As a result, we have been able to forge a very close relationship with "China's Silicon Valley", both with its companies and its institutions and authorities. The other technology event is the Mobile World Congress Shanghai, the "sister" of the fair held in Barcelona, which we attended this year for the second time to showcase our event for entrepreneurs and investors, 4YFN (Four Years From Now), accompanied by 16 companies.

The design sector has a long-standing tradition in our city and has been of vital importance. This led to Barcelona being invited to the 2014 Beijing Design Week and to last year's Hong Kong Business of Design Week. Both occasions saw the successful participation of companies that used these activities as a springboard to enter the Chinese market.

The Smart Cities sector is also noteworthy. Barcelona is a global benchmark and every November the city organises an international fair and conference, Smart City World Congress and Expo, which brings various companies, authorities and institutions together in our city. At the next event, which will take place from 19 to 21 November 2016, we will have the pleasure of welcoming China as the guest country.

Connection by air

Since 2014, Air China has been operating three flights a week connecting Barcelona to Beijing. We are currently working to secure a direct flight to Shanghai, possibly by 2017. The city council is very closely involved in this matter through the Committee for the Development of Air Routes (CDRA).

3.3. Portugal, where Chinese investment is consolidating and continuing to grow

As in Spain, the presence of Chinese companies in Portugal is a recent phenomenon, but has gathered intense pace since 2011. Following the period of privatisation (2011-14) instigated under a plan approved by the troika (the IMF, ECB and European Commission), foreign investment in Portugal has begun to consolidate and investors, including Chinese companies, have maintained their interest in the Portuguese economy.

According to the ESADE China Europe database, Portugal received USD 7.23 billion in Chinese investment[49] in the 2010-2015 period (8% of the total for Europe), and was the sixth-ranking beneficiary of Chinese investment in the European Union, in the wake only of the United Kingdom, Italy, France, Ireland and Germany. The amounts invested in Portugal are very high in comparison with its economic weight in Europe.

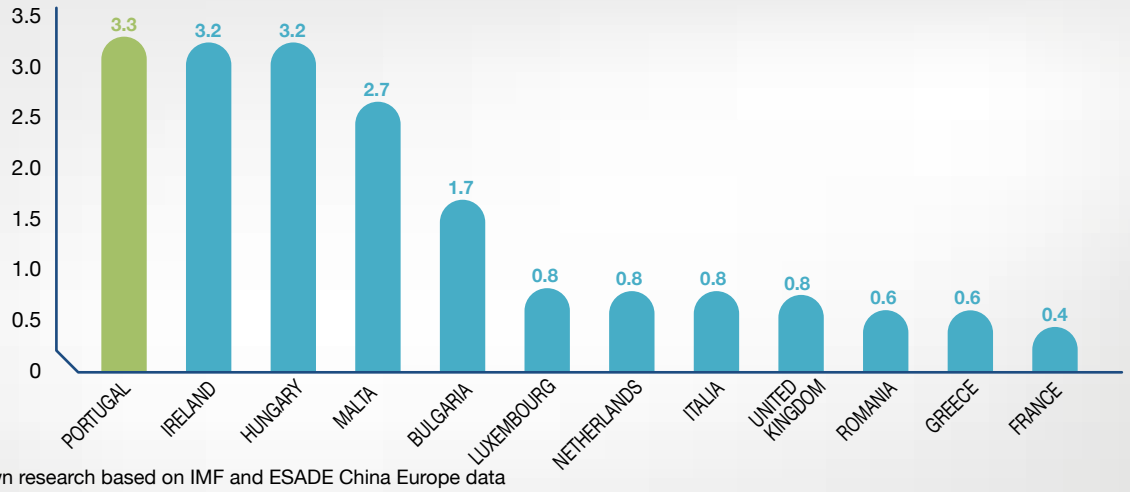
As can be observed in chart 12, Portugal has the largest Chinese investment-to-GDP ratio of all European countries, a strong indicator of China's commitment to this country with just 10 million inhabitants, smaller than the population of Beijing. It is also significant that Portugal is ahead of countries such as Luxembourg, which is the tax and operating headquarters of numerous Chinese companies and has a population of just over 500,000.

Why have Chinese investors chosen Portugal as one of their preferred launchpads into the European Union?

The sharp rise in Chinese investment in Portugal can only be understood within the context of the economic crisis in the Eurozone, specifically Southern European countries, which emerged in 2008. In Portugal, the government approved a three-year scheme (2011-2014) with the troika (the IMF, ECB and European Commission) for an amount of €78 billion (USD 101.4 billion)[50]. The scheme set out an ambitious package of state-owned assets to be privatised, encompassing the transportation (Aeroportos de Portugal, TAP), energy (GALP, EDP and REN), communications (Correios de Portugal) and insurance (Caixa Seguros) sectors. Chinese capital has been injected into various state-owned enterprises in Portugal as part of operations that have entailed major advantages for both parties. For Portugal, the commitments agreed with the troika were met, whilst at the same time the country could further its economic relationship with the second global economy. From China's perspective, it was the realisation of an opportunity to enter into the European market at attractive purchase prices and to participate in low-risk operations (thanks to the profile of the acquirees), with a stable and recurrent customer portfolio.

The first transaction carried out was the acquisition by China Three Gorges of a 21.35% interest in the state-owned enterprise Energias de Portugal (EDP) for USD 3.51 billion (€2.7 billion) in 2011. Significant benefits for both the Portuguese and Chinese firms arose from the transaction: the Portuguese firm obtained financing of USD 1.1 billion from the China Development Bank, allowing it to settle its financial obligations more

Chart 12 European countries with highest level of Chinese investment in relation to the size of their economies (2015)



Source: own research based on IMF and ESADE China Europe data

[49] The ESADE China Europe database only reflects investment from mainland China for all countries of the European Union included in this study.

[50] Average euro-US dollar exchange rate of 1.3 applied: http://es.investing.com/currencies/eur-usd-historical-data

comfortably. As part of the operation, the Chinese firm also undertook to invest USD 2.2 billion in renewable energies. The investment had strategic value for the Chinese firm as it gained access to new markets. For example, the two companies have created Hydroglobal, a joint venture to develop hydroelectric projects in various Latin American and Portuguese-speaking African countries; and, through CWE Investment, China Three Gorges (CTG) has acquired a 50% stake in Cachoeira Caldeirao and Jari, the entities holding the rights to develop hydroelectric plants in Brazil. As in the case of Spain with its Spanish-speaking ex-colonies, one of the magnets for Chinese firms is Portuguese companies' access to third markets, such as Brazil, but also Angola and Mozambique, where the European country enjoys a strong business presence due to its historical links. Moreover, thanks to this opportunity, the reduced size of the Portuguese market has not been a drawback to investor firms interested in securing new customers and consumers.

In a second, similar operation carried out in 2012, the Chinese electricity group State Grid Corporation acquired a 25% holding in Rede Eléctrica National (REN), the largest electricity company in Portugal, for USD 510 million (€390 million). The Oman Oil fund acquired the remaining 15% of the target 40% interest to be sold under the privatisation plan. Once again, the operation included a financing facility valued at USD 880 million, granted to the Portuguese company by the China Development Bank. Beyond this sale, a number of other transactions have also been carried out in the energy sector, including the investment by China Three Gorges to acquire a 49% stake in EDP Renováveis for USD 475 million.

This rush of Chinese investment in Portugal has been accompanied by the arrival of two large Chinese banks – ICBC in 2011 and the Bank of China in 2012 – which made similar investments of close to USD 30 million each.

Another major operation undertaken by Chinese investors in Portugal is the acquisition of Caixa Geral, the first bank in Portugal by volume of deposits, which in turn owns Fidelidade, the country's largest insurance company, by the private group Fosun International Limited in 2014. The acquisition of Fidelidade by the Fosun Group had a price tag of USD 1.36 billion (€1.04 billion). In addition, the Novo Banco investment bank (Banco Espírito Santo de Investimento) was taken over by the Chinese group Haitong Securities for USD 466 million during the same year. This operation also helped the Chinese group to gain a foothold in different markets, such as London and New York, where the Portuguese bank already had a strong presence.

Aside from the operations carried out under the privatisation plan, a number of other transactions not directly related to the troika were also carried out in the 2011-14 period. Transactions conducted in the private sector since 2011 include French water management group Veolia Water's sale of Compagnie Générale des Eaux (Portugal), responsible for water purification and treatment, to the Chinese firm Beijing Enterprises for USD 129 million in 2013. This was followed by certain greenfield projects in the telecommunications sector, such as the investment made by Huawei, which has had a foothold in Portugal since 2011 and has made a number of subsequent investments, culminating in the creation of an R&D centre.

In 2015 Chinese investment in Portugal entered a new phase, which sees the consolidation of the investment already received and the signing of new transactions. The most recent major transactions include Fosun International's purchase of Espírito Santo Saúde. The first steps towards this acquisition were taken in late 2014, with subsequent developments in the form of a name change for Hospital Luz Saúde and the purchase of land close to the hospital. The total investment has been valued at USD 621 million and was included in the ESADE China Europe database in early 2015.

More recently, in 2015, the e-commerce company yuwibuy.com made an investment totalling USD 65 million. As in other European countries, including Spain and Italy, lately Chinese investors have also begun to position themselves in the football industry in Portugal. For instance, Ledman, a Chinese manufacturer of LED lamps, sponsors the Portuguese second division championship.

Lastly, Chinese investors have also undertaken major investments in Portugal by taking advantage of the Golden Visa programme launched in Portugal, which grants non-EU citizens residency permits (including those for family members) for the purchase of a property or an investment of at least €350,000 (approximately USD 385,000). The aim of such investments is normally to enable the family members of investors to live in cities with European standards of living. This scheme was launched in 2012 and has been met with strong demand, generating more than €1.7 billion (nearly USD 2 billion) in property investments, with Chinese citizens among the foremost

Table 5	The 10 largest investments by Chinese firms in Portugal (2010-2016)				
	YEAR	**ACQUIREE**	**BUYER**	**VALUE ($ MILLION)**	**SECTOR**
1	2011	EDP - Energias de Portugal	China Three Gorges	3,510	Energy
2	2014	Fidelidade (Caixa Geral)	Fosun International	1,360	Insurance
3	2015	Espirito Santo Saúde (Luz Saúde)	Fosun International	621	Healthcare
4	2012	REN - Redes Energéticas Nacionais	State Grid	510	Energy
5	2012	EDP Renováveis	China Three Gorges	475	Energy
6	2014	BESI - Banco Espirito Santo de Investimento	Haitong Securities	466	Financial
7	2013	Compagnie Générale des Eaux	Beijing Enterprises	129	Water
8	2015	Greenfield project	Yuwibuy.com	65	e-commerce
9	2012	Greenfield project	ICBC	31	Financial
10	2016	EIP - Electricidade Industrial Portuguesa	Shandong Taikai	30	Energy

Source: ESADE China Europe database

beneficiaries of this initiative. As of May 2016, 2,651 visas had been granted to Chinese citizens, accounting for 77% of the total number extended since the scheme's launch.

Another transaction may be successfully negotiated in the financial sector in the upcoming months. The Fosun Group has declared its interest in acquiring a shareholding of more than 16% in Banco Comercial Português (BCP) through a share capital increase, which it hopes to gradually increase to 30%.

In short, although Chinese investments in Portugal were initially in response to the opportunity brought about by its privatisation programme, this trend has since given way to a second stage, buoyed by the positive experience of Chinese companies in this country and supported by the opportunities Portugal offers at industrial level and in the services sector, both in terms of the local market and as a gateway to the rest of Europe and other Portuguese-speaking countries. In this respect new operations can be expected in the future, in view of the interest shown to date in exploring new investment opportunities available to Chinese firms and the overlap between what Portugal has to offer and the assets sought by Chinese investors. In addition to the financial sector, three other areas have been of particular interest to Chinese companies and could be the recipients of new funds: energy (specifically water treatment) ; medium-sized companies with a known brand image and a presence in third markets, with a preference for those specialising in products such as wine or olive oil; and the leisure and sports industry, with particular emphasis placed on hotel groups, resorts and golf courses, as well as football clubs.

Box 4.

Recent Chinese investment in Portugal

Authors: Gonçalo Bastos Lopes and Vasco Bivar de Azevedo. Partners – China Desk Portugal. Cuatrecasas, Gonçalves Pereira.

Chinese foreign investment has been growing for at least the last 13 years. Excluding the purchase of currencies and financial products, foreign investment came to USD 118 billion in 2015 and is expected to reach USD 300 billion by 2025. However, the largest percentage increase in Chinese investment in Europe was seen in 2011, when it rose by 57.3% on 2010. The reason for this is a confluence of opportunities and China's ample liquidity surplus of €2.47 billion of foreign currency reserves recorded in 2011, which naturally influenced the markedly expansionist policies regarding Chinese foreign investment, supported by the central committee since the first decade of the century and expressly stipulated in China's 12th Five-Year Plan under the concept of "Go global".

Although Portugal had already been attracting Chinese investment (companies such as ZTE, Huawei or APMCQ were already operating in the market through their subsidiaries), 2011 marked a turning point in a process that, three years later in 2014, would see this country become the fourth-ranking recipient of direct Chinese investment in Europe, ahead of countries such as Germany or Spain, positioning it as the European country with the highest ratio of Chinese FDI to per capita GDP, and therefore one of the most attractive destinations for Chinese FDI in Europe. This situation continued until 2015, when Portugal dropped one place down the ranks to be overtaken by Germany, despite being far ahead of countries such as Spain or the Netherlands, which are higher up in the ranking of European economies.

The notable increase in Chinese FDI in Portugal from 2011 onwards is clearly not unrelated to the opportunity presented to international investors in the form of the privatisation programme initiated that same year in compliance with the memorandum of understanding signed between Portugal and the troika. However, this alone cannot explain the scale of the phenomenon, nor can it account for the sustained interest of Chinese investors in the Portuguese economy, which continues to this day.

In reality, an opportunity was created by the execution of this privatisation programme from 2011 onwards, which brought to market a collection of highly attractive stakes held by the state in Portuguese companies of great national and international relevance, as evidenced by the enthusiastic response to the various sale processes and the notable number of investors that bought in (not just Chinese, but also German, French and North American). Equally important is the fact that the Portuguese economy has a very open attitude to foreign investment, with the geographical origin of capital never having posed a problem for investors. Lastly, the extraordinary liquidity available to Chinese investors – predominantly SOEs – during the privatisation process enabled them to make the best offers and thereby successfully acquire the state's stakes in the most desirable Portuguese companies being sold as part of the privatisation programme initiated in 2011.

By way of example, CGT acquired 21.35% of EDP in December 2011 for €2.7 billion and State Grid acquired 25% of REN for €390 million in February 2012. Both operations gave substantial visibility to these investments in the markets in which the participating companies operate, particularly in China. The complexity of the operations associated with these acquisitions, which required additional financing to be obtained from Chinese banks to acquire the target companies, coupled with the growing interest of Chinese investors in the national market, led Industrial and Commercial Bank of China (ICBC) (in February 2012) and subsequently Bank of China (in February 2013), two of the largest SOEs in the Chinese financial sector, to open their representative offices and branches in Lisbon. Also in February 2012, Huawei inaugurated a large research and development centre in Lisbon, thereby reinforcing its presence in Portugal through this new investment, which has been calculated at around €10 million.

Chinese investment in Portugal, which until the end of 2013 had been led by the top SOEs in China, received a significant boost in 2014 from the Chinese private sector through Fosun's purchase of the portfolio of Caixa Seguros, which includes Companhia de Seguros Fidelidade, for €1.7 billion. Once under the control of the Shanghai conglomerate, in October 2014 it acquired 96% of Espírito Santo Saúde for €478 million, as well as a 5% interest in REN, a subsidiary of the SOE State Grid. The final Chinese acquisition for 2014 was the purchase of 100% of Banco Espírito Santo de Investimento (BESI) by Haitong for €380 million.

Moving into 2015, the insurer Hanbang and, once again, Fosun competed to acquire an interest in Novo Banco, a business valued at €4 billion (temporarily suspended by Banco de Portugal) and, more recently, Hainan Airlines indirectly acquired an interest (by purchasing shares of the shareholder Atlantic Gateway) in Air Portugal, in addition to announcing the purchase of 25% of the convertible bonds of TAP for €30 million, which were issued for the purpose of financing the company's operations in Africa and Europe. This shows that the interest of Chinese investors in Portuguese assets and companies goes beyond the apparent opportunism that may have been a factor in the first acquisitions.

An analysis of Chinese investment in Portugal in recent years would not be complete without looking at the programme of Residence Permits for Investment Activities (ARI) launched in 2012, whereby citizens from countries outside the EU are granted a residence permit in Portugal for carrying out any category of investment activity defined in the legislation (current minimum amount of €350,000). Until now, this scheme has attracted around €1.7 billion in FDI, mostly from Chinese investors, with 77% of residence permits granted for investment activities thus far having gone to Chinese citizens. In addition to the undeniable benefits of the programme as a tool for attracting investment, particularly from China, it also gave Portugal greater visibility among the middle and upper class families in China

who make use of the programme and whose members tend to occupy high positions in the business world, thereby increasing the propensity for new investments, especially in the real estate and tourist sectors.

Direct investment in Portugal originating from China (including the special administrative regions of Macau and Hong Kong) between 2000 and 2015 totals around USD 10 billion, although we also need to factor in the multiplier effect of the entry of new capital into the Portuguese economy, particularly in the real estate sector, which has not been accounted for.

Chinese investment in Portugal in recent years, which has been highly focused on the operations of the target companies and setting long-term goals, coupled with the current propensity of Chinese investors to invest in Europe's technological sector and the so-called leisure business, which encompasses the real estate and tourism sectors, where Portugal still has attractive assets, would suggest that the trend displayed by Chinese FDI, particularly in the last decade, will not reverse in the coming years and Portugal will continue to be a favourite destination for Chinese investment.

In this respect, the tax and legal framework in force in Portugal currently includes other provisions that may prove especially attractive to non-European investors, including, of course, investors from China.

In addition to the general simplification and significant reduction of the bureaucracy and procedures associated with many aspects of doing business in Portugal in recent years, the tax regimes known as the participation exemption regime and the regime for taxation of persons not ordinarily resident in the country are noteworthy.

The participation exemption regime affects corporate income tax by granting a total exemption from capital gains tax for dividends and gains on the disposal of shares, including those derived from investments outside the European Union, thereby definitively establishing Portugal's place as a fiscally attractive destination for Chinese investment both within and outside the EU, with emphasis on investment in Portuguese-speaking countries such as the so-called PALOP and Brazil.

The regime for the individual taxation of persons not ordinarily resident in the country is an important tool for attracting the residence of retired persons, other high net worth individuals, or business owners and other professionals in certain areas considered of high added value, as it establishes exemptions or reductions in taxation for a period of 10 years, especially for income from pensions or from capital invested abroad. This regime for the individual taxation of persons not ordinarily resident in the country may also be a catalyst for attracting Chinese FDI in Portugal as it ties in with the programme of Residence Permits for Investment Activities (ARI).

3.4. Greece, the strategic value of the Port of Piraeus

As has been well documented, Greece experienced the sharpest economic contraction during the Eurozone crisis, inflicting devastating social consequences on the country: the Greek economy has shrunk by 25% since the onset of the crisis, youth unemployment stands at 60% and 45% of pensioners receive benefits below the poverty line. With its public accounts in disarray and an urgent need for financing to meet its payments in the short term, the Greek government signed an initial bailout package (European Stability Mechanism or ESM Programme) for €110 billion (USD 132 billion) in 2010, followed by a second bailout for €130 billion (USD 156 billion) in 2012. A third package for €86 billion (USD 94.3 billion) was signed in 2015, and is still in place. In exchange for the financial aid awarded by the troika, the Greek government was required to implement sharp cuts to its welfare state, to raise taxes across the board, and to sell off state-owned assets, in order to achieve greater stability in its public finances and fiscal balance in the medium term. These measures provoked profound social unrest in Greece, and reaffirmed the loss of room for manoeuvre in the public accounts for the government in Athens. Against this backdrop, and in view of the lack of support in Europe, Greece sought a rapprochement with other countries such as Russia, Iran and particularly China. China's involvement in the Greek problem arrived in the form of direct investment in recent years, specifically through an operation carried out in 2016.

The operations undertaken by Chinese companies in Greece have been minimal to date, the Hellenic Republic being one of the largest countries to be overlooked by Chinese capital. The Bank of Greece's breakdown of investment received provides data on the 19 main countries that have made a significant investment in the country, which notably do not include China. The minimal presence of Chinese companies in Greece is essentially attributable to two factors. On the one hand, the fragile economic situation of Greece since 2008, which led to a debate as to the country's possible exit from the Eurozone, has coincided with the period in which Chinese companies have begun to funnel funds into Europe. On the other, Greece has no specialist business with a significant technological component that could stir the interest of Chinese firms. However, despite this generalised apathy from China, the acquisition by the shipping giant COSCO of the management rights of the Port of Piraeus has recently been agreed. This is of major strategic importance and could lead to numerous positive externalities for Greece.

This sale was agreed as part of the aforementioned third bailout. In exchange for this bailout, the Greek government undertook a programme to privatise state-owned assets for an amount equivalent to €50 billion (USD 55 billion), which opened the door to foreign investment from funds and large companies seeking to enter the Greek market through such acquisitions. Two major operations have been agreed since the approval of the third bailout: privatisation of the management of 14 airports, valued at €1.23 billion (USD 1.35 billion), which was awarded to the German firm Fraport; and the concession for management of the Port of Piraeus, awarded to the China-based COSCO Shipping Group.

The Chinese group, one of the largest in its sector globally, submitted a bid of €1.5 billion (USD 1.64 billion) for control of 51% of the state-owned company Piraeus Port Authority, which manages the Port of Piraeus. The agreement also includes commitments for the Chinese firm to invest €350 million (USD 383 million) in port infrastructure over the next ten years. COSCO had already been present at the Port of Piraeus since 2009 through its acquisition of one of the two cargo terminals and its subsequent construction of a third terminal. However, the acquisition of the Piraeus Port Authority has afforded the Chinese firm an even greater presence at the port.

The purchase was of particular importance at that time due to its compatibility with the OBOR initiative, as the Maritime Silk Road shipping route ends in Greece. The Chinese group's commitment to the Port of Piraeus, as well as its investment to participate in its management and expand its capacity, place the group in a privileged position with respect to becoming the main maritime gateway into Europe for Chinese products within the framework of the OBOR initiative. For example, Greece could become the entry point for Chinese products destined for Eastern and Central European countries, a region to which China attaches great importance. In any event, the Port of Piraeus operation should not be taken as a final achievement, but rather as a significant first step. Any possibility of the port in Athens truly multiplying its capacity and becoming the main commercial maritime platform in Europe, without creating bottlenecks, will require the start-up of complementary infrastructure and logistics services. A further consideration is that in 2015 China also acquired a terminal at the Port of Kumport in Turkey, located on the Bosphorus strait, which is closer to Eastern European markets such as Bulgaria and Romania.

Table 6 Assets included in the third Greek bailout

ASSET	DESCRIPTION	PRIVATISATION METHOD
Regional airports	Airports	40-year concession + 10 years
Hellinikon	Athens airport	Sale of 100% of specified shares
Astir Vouliagmenis	Hotel complex	Sale of shares
Afandou Rhodes	Tourist development	Sale of 100% of specified shares
Hellenic Gas	Gas distribution	Sale of 66% of shares
Piraeus Port Authority	Port management	Sale of 67% of shares
Thessaloniki Port Authority	Port management	Sale of 67% of shares
Trainose	Railway services	Sale of 100% of specified shares
Athens Airport	Athens airport	Sale of 30% of shares
Poseidi Chalkidiki	Tourist development	Sale of 100% of specified shares
Markopoulo Equestrian	Sports centre	40-year concession
E-auction	Properties	Property auctions
Marinas	Marina	40-year concession
Egnatia Motorway	Motorway	35-year concession
Hellenic Petroleum	Oil refining and distribution	Under evaluation
OTE	Telecommunications	Under evaluation
Public Power Corporation	Electricity	Sale of 17% of capital
EYATH	Water supply (Thessaloniki)	Sale of 23% of capital
EYDAP	Water supply (Athens)	Sale of 11% of capital
Public Gas Corporation	Importer and distributor of gas	No information
Hellenic Post	Postal services	Under evaluation

Source: Hellenic Republic Asset Development Fund, 2015 [51]

The other major transaction was the entry of the private group Fosun, which in 2011 acquired a 9.5% stake in Folli Follie, a Greek firm that designs and sells jewellery, in an operation valued at USD 92 million. The financial difficulties suffered by the Greek firm as a result of the economic crisis were leveraged by the Chinese conglomerate in order to take a shareholding therein. The investment enabled the Chinese firm to develop its know-how and production capacity so as to enhance its standing in the thriving Chinese luxury goods sector, and allowed the Greek company not only to reduce its financial difficulties but also to enter the complex Chinese market with the assistance of a local partner.

Greece also has a Golden Visa scheme to grant residency in the country based on the volume of investment in real estate assets. Visas are awarded for investments of a minimum of €250,000 (USD 275,000), although the scheme has not proven as successful as in Portugal, with just 983 Golden Visas awarded between June 2013 and October 2015, of which 335 were for Chinese citizens.

Chinese investment in Greece is expected to continue to grow over the coming years. Forecast investments to extend and modernise the Port of Piraeus should generate a major traction effect and open new niche opportunities in different sectors of the Greek economy, which could lead to further Chinese investment in the country. Other major projects are also on the table, such as that planned by the BCGI group to develop a hotel complex near the Port of Piraeus, and the construction of Kastelli airport on Crete, one of the leading tourist destinations in the country. The works for the latter have been budgeted at €900 million (USD 986 million) (to be co-financed by the European Investment Bank) and are scheduled to take place over a period of five years. The new airport would be the country's second largest, after Eleftherios Venizelos in Athens. The works have been postponed on various occasions, but a visit by a delegation from the China State Construction Engineering Corporation (CSCEC), the largest construction company in the world, and the Ministry of Economy in mid-2015 augurs a swift launch for the project.

Moreover, the possibility of further Chinese investment being channelled into Greece as part of its privatisation programme should not be ruled out. Given the numerous investment opportunities set out in the Asset Development Plan and the clear interest of Chinese investors to gain footholds in Southern Europe, over the coming quarters we could see Chinese firms taking further shareholdings under the privatisation processes in force. As shown in table 6, the privatisation programme encompasses sectors where Chinese investors have already made investments in Europe, such as the electricity industry and water supply management. Chinese companies have already proven to be more than willing to inject capital into state-owned enterprises as one of their preferred methods for entering the European market. The possibility of new transactions being conducted will therefore depend to a large extent on the success of the Port of Piraeus operation.

[51] The information is provided for informative purposes and is not exhaustive. The status of some of the assets mentioned may since have changed. For a more detailed description, see: http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/pdf/01_mou_annex1_20150730_en.pdf

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