



## ECONOMIA MARCHE Journal of Applied Economics

Vol. XXXI, No. 1, June 2012

---

# Italian FDI in China: analysis and implications for the new EU investment policy

**E. Vanino** *Università degli Studi di Padova*

---

### Abstract

In 2009 the Treaty of Lisbon expanded the competences of the EU creating a Common Investment Policy. China has been defined by the European Commission as a perfect candidate for a future bilateral investment agreement. This research would like to investigate the impact of changing EU-China investment relationship on European firms' behaviour. After an abstract of theoretical contribution on BIT effects, a model of motivations of European inward investments in China will be analysed, based on data from the Italian direct investments in the Guangdong region, examining whether an EU-China agreement could help European investors to tackle their growing needs.

**JEL Classification:** *F21; F23; F53*

**Keywords:** *FDI; EU Investment Policy; China; Guangdong; Italian Investment; BIT.*

---

### Affiliations and acknowledgements

Enrico Vanino, Università degli Studi di Padova, Italy. E-mail: [enrico.vanino@gmail.com](mailto:enrico.vanino@gmail.com).

### Suggested citation

Vanino E. (2012), Italian FDI in China: analysis and implications for the new EU investment policy, *ECONOMIA MARCHE Journal of Applied Economics*, XXXI(1): 69-89.

---

# 1 Introduction

In 2009 the Treaty of Lisbon further expanded the competences of the EU in the Common Commercial Policy field, covering trade in goods and services, commercial aspects of intellectual property and even more important foreign direct investments<sup>1</sup>. The key innovation was the creation of a new Common Investment Policy, which includes EU competence to negotiate international investment agreements, covering both market access and investment protection. Moreover, it also consists in the harmonization of the non-transparent patchwork of EU member states BITs, firstly strengthening the market access and investment protection of EU investors in third countries, and then creating an equal level playing field for foreign investors in the EU (Messerlin, 2010). Taking advantage from economies of scale and spillover effects, the Union aims to reach better results compared to the ones obtained so far by each Member State separately. The future action in this field should therefore be guided by the research for the best available standards, in order to obtain the most complete and comprehensive agreement, through a greater diplomatic power, especially with the largest EU economic partners (Kleinheisterkamp and Woolcock, 2010).

Today, the EU is both the world's leading host and source of FDIs. As a market leader, the EU benefits from its openness to the rest of the world, especially in the investment area. The European Union investment policy should follow its investor's major interests, through the liberalization of investment flows and ensuring free access to the most important markets. In this regard, markets with significant economic growth or interesting growth prospects represent a particular opportunity in the current competitive environment. The EU interests in investment negotiations should also be determined by third parties' political, institutional and economic climate, defining in this way the priority countries for the future EU investment negotiations. For all these reasons a large nation such as China, characterized by a high proportion of greenfield investments from the EU and a huge potential unexploited market, has been defined by the European Commission as a perfect candidate for a stand-alone investment agreement<sup>2</sup>. The EU and China are among the world's largest originators and recipients of foreign investments, but investment flows between the two regions remain limited in comparison with a continuously increasing trade relationship. Although European investors identify China as a location that holds great unexploited potential, growing concerns still remain about the lack of a level playing field in China as well as persistent barriers and uncertainty in the business environment. The share of European FDI in China has reached an average of about 20% of total FDIs in China in recent years, making the EU the third largest foreign investor, although this represents less than 5% of the EU's total overseas FDIs. At the same time China is becoming a more active investor abroad and now ranks among the top 10 global outward investors, with a growing share of Chinese investments in the EU. Unfortunately, optimism about growth does not automatically translate into confidence in China as a sustainable and predictable investment environment, and the barriers to the Chinese market are a persistent concern. Moreover, looking at the protection of European investments in China, there still exists a patchwork of Member States bilateral investment treaties (BITs), which differ in

<sup>1</sup> Consolidated version of the Treaty on the Functioning of the European Union - Part five: External action by the Union - Title II: Common Commercial Policy - Article 206, 207 (ex Articles 131, 133 TEC), Official Journal 115, pp. 140-141, 09/05/2008.

<sup>2</sup> EC COM(2010)343 final, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Towards a comprehensive European international investment policy, Brussels, 07.07.2010.

approach and scope. A negotiation of a comprehensive investment agreement between the EU and China would offer the opportunity to create a single framework applicable to investors from all EU-27.

This research would like to investigate the implications of the changing relationship between Europe and China in the investment field on the European firms' behaviour in China. To do so, first of all, it will offer an abstract of literature and theoretical contribution on Bilateral Investment Treaties effects. Secondly, a model of motivations and determinants of European inward investments in China will be proposed, based on dataset and comments from the Italian Direct Investments in the Guangdong region in southern China, analyzing the presence of Italian firms and the major characteristics of Italian FDI in the area. This kind of analysis could be very useful in order to examine whether an EU-level agreement with China could help European investors to tackle their growing needs and concerns with regard to China's increasing importance as a destination for European FDI.

## 2 Related Literature

Given China's increasing importance as a market place and destination for European investors, it is essential to examine whether an EU-level agreement, combining both investment liberalization and a uniform standard of protection, could address the needs of the European investors in the increasingly competitive Chinese market, as well as solve European concerns about the effects of more Chinese investment in Europe.

### 2.1 BIT impact on FDI flows

Bilateral Investment Treaties (BITs) are international agreements concluded between two countries in order to regulate and protect the investments flows between them. BITs have become more and more important over time to promote investment liberalization and regulate its protection, as demonstrated by the huge growth in the number of such agreements in recent years, reaching a total amount of 2.807 BITs at the end of 2010<sup>3</sup>. Most of these treaties have much in common. They all aim at eliminate restrictions on foreign investments, remove discrimination against foreign investors and protect from discriminating actions such as nationalization or expropriation from government (Barba Navaretti and Venables, 2004). Recently, BITs addressed not only FDI issues related to investment protection, but tried to promote investment liberalization too. Consequently, recently BITs have been encouraged by developed countries as instruments to encourage FDI inflows to developing capital importing countries, as a tool of investment liberalization (Bergstrand and Egger, 2012).

Formally, BITs regulate FDI-related issues such as admission, treatment, expropriation, and the settlement of disputes at the bilateral level. First of all, BITs try to facilitate and encourage bilateral FDI between the contracting parties, establishing transparency about risk, reducing in this way the risk of investing in a country. Usually, to achieve this goal, many of the existing BITs, especially the "last-generation" treaties, guarantee to foreign investors a fair-and-equitable, non-discriminatory, and "national" treatment (UNCTAD, 2007). Secondly, BITs usually provide legal protection of both physical and intellectual properties under international law, with a special focus on the transfer of funds and expropriation, assuring the rules of

<sup>3</sup> UNCTAD, World Investment Report 2011: non-equity modes of international production and development, UNITED NATIONS publication, no. E.11.II.D.2, Geneva.

compensation. From this perspective, BITs reduce the costs of investing abroad so that FDI should increase if new BITs are implemented (Egger and Pfaffermayr, 2004).

Although little is known about the effective use of BITs provisions by countries or foreign investors, the main function of these treaties is to state the attitude of contracting parties towards FDIs, creating a credible policy commitment and enhancing stability and transparency, finally forming an important element of the standard investment climate for any country interested in attracting inward foreign investments (UNCTAD, 1999).

Nevertheless, while BITs can be important instruments for the protection of investments, there is little evidence yet of whether these instruments really affect the allocation of foreign investments and their positive impact on social welfare. Several studies provided empirical investigations about the benefits that BITs really provide, if they could stand as substitutes for weak domestic laws and about their role in increasing FDI inflows. Within the economic literature, BITs have generated very little attention, and the results were quite controversial (Sachs and Sauvant, 2009). Generally, the importance of property rights, and the quality of domestic institutions, have been recognized in several studies on growth and investment (Daude and Stein, 2001; Dollar and Kraay, 2002; Rodrik *et al.*, 2002; Hallward-Driemeier, 2003), finding a large effect of institutions in attracting FDIs. Nevertheless, the UNCTAD in 1998 in one of these analyses studied the impact of 200 BITs on bilateral FDI data. It found a weak correlation between the entry into force of BITs and changes in FDI flows. In particular, those countries with weak domestic institutions did not experience significant additional benefits: BIT did not act as a substitute for broader domestic reform. Rather, those countries already engaged in the reforming process and with reasonably robust domestic institutions could gain several benefits from ratifying a treaty. According to Hallward-Driemeier (2003) this is the evidence that BIT acts more as a complement than a substitute for robust domestic legal institutions. Even if weak countries have already signed BITs, difficultly foreign investors would rely on the treaties to assure investment protections. Differently, in middle-income countries with strong political commitments, such as China, firms are confident about the enforcement of property rights for all investors. In these cases, their quite-stable investment environment enables them to better negotiate the treaties terms, experiencing more benefits from the application of BIT improvements (Rose-Ackerman and Tobin, 2005). Only once a country achieves low level of political risk, BITs may become important in order to attract FDIs.

While these findings suggest that BITs do not serve to attract additional FDIs, more recent studies seem to provide quantitative evidence that a higher number of BITs raises the FDI flows to developing countries. For instance Egger and Pfaffermayr (2004) find out a significant and positive impact of ratified BITs, additionally addressing the analysis of the anticipation effect about simply signing a BIT. In order to reach those results, the authors used the largest available dataset of bilateral outward FDI stock from the OECD and a comprehensive data set on bilateral investment treaties from the World Bank, finding an overall BIT ratification effect on FDI of about 30% in the ideal case.

Moreover, also Neumayer and Spess (2005) found out significant increase in FDI inflow (more than 40%) related to the substantial proliferation of BIT activity, demonstrating that the benefits of signing BITs are higher than the substantial costs in which developing countries usually incur negotiating and implementing those agreements. Additionally, from their research is it possible to figure out limited evidence that BITs might function as substitutes for good domestic institutions, even if those results are not quite robust. According to the authors, the previous studies suffered from small and non-representative samples, and from misconducting

analysis techniques which could hinder to detect how a higher number of BITs could raise the flow of FDI (Neumayer and Spess, 2005; Egger and Pfaffermayr, 2004).

Nevertheless, in one of the most updated studies Aisbett (2009) shows how Neumayer and Spess (2005), as well as other scholars, failed to properly take into account the endogenous relationship between BITs and investment flows. As successively demonstrated by Poulsen (2010) as well, these studies, based on aggregate flows and the total number of BITs, fail to separate more accurately the effects of BITs from the strong upward trend in FDI over time, finding out fictive strong evidence of BIT impact on FDI flows.

Indeed, it is difficult to evaluate the impact of BITs on FDI flows, especially taking into account that the selection of BIT partners is usually endogenously and politically determined (Guerin, 2010). For instance, according to Hallward-Driemeier (2003) it is possible that a reverse causation subsists: that the existence of extensive FDI flows represents a strong incentive for a country to conclude a BIT with the host country. Since there could be a positive feedback from FDI to the probability that a BIT is ratified, it becomes crucial to take into account and to differentiate between BITs provisions in order to determine their impact on FDI. For example, BITs with market access provisions would be expected to have a greater impact on investment flows than BITs covering only the post-establishment phase, while BITs which incorporate a legally binding arbitration procedure are likely to be better valued by investors than BITs where such opportunity is limited or even absent (Ginsburg, 2005).

To sum up, FDI flows are determined by a large range of regulatory, political and economic factors that could easily prevail over BITs positive effects. Many of these aspects are difficult to estimate in a quantitative way, also due to the fact that FDI data are measured in various and incompatible ways. For these reasons, we deem necessary to directly ask to the actors involved in investment decisions about their investment behavior and the evaluation of the relevance of BITs, especially in the case of investors operating in China.

### 3 Data and Methodology

Considering these controversial literature results, the only way to properly tackle this issue was to directly address the European investors in China, the economic actors wholly involved in the quarrel. For this reason the survey is focused on the FDI inflows from one European region, Italy, to one Chinese province, the Guangdong region, considered as a particular case study of the broader phenomenon of EU FDI inflows to China. The research aims firstly at taking a deeper look at the main motivations of Italian investments in the region in order to create the empirical basis enabling to better understand the implications for an EU-China BIT.

#### 3.1 The Guangdong Region

The research work was carried on in the southern-China coastal province of Guangdong, perfect location to conduce this kind of data collection, since it is broadly defined as the “world’s factory”, where roughly 30% of worldwide “Made in PRC” large-scale consumption goods are produced, and where China’s transition towards a developed economy started. Indeed, this region was chosen by Chinese authorities as the first test base for the “Open door” policy at the end of 70s, transforming it from an agricultural lagging region into a dynamic industrial economy. The Guangdong became in this way the largest economy in China and has been the principal driver of national growth over the last 30 years, accounting for 105 million inhabitants,



the 7,8% of China's population, and producing approximately the 11,5% of national GDP<sup>4</sup> (Enright *et al.*, 2005). Moreover, the Guangdong success has been built on an externally oriented model, characterized by high FDI inflows and a high ratio of trade to GDP. Starting from 1980s, throughout its three "special economic zones" (SEZs) a huge stock of foreign direct investments and technologies were gradually introduced in China, driven by the globalization of supply chains which pushed Hong Kong, US, Japanese and European MNEs to relocate their component manufacturing processes (OECD, 2010). The Guangdong therefore became the main receiver of China's incoming FDI, reaching a total amount of 14,58 billion FDI in 2010, 25% of China's total FDI from 1978, and becoming the largest exporting province in China, with a trade balance in 2010 accounting for 542,76 billion, representing alone the 25,4% share of global Chinese trade balance<sup>5</sup>. Globally about 69.000 foreign invested firms were enrolled in the Guangdong province, particularly focused on the manufacturing industry, followed by trading and retail services and B2B services. According to the Italian Trade Commission in 2011 about 150 of them were invested by Italian capitals<sup>6</sup>.

Its economic structure is mainly driven by the manufacturing sector, heavily embedded in the province economy contributing to the GDP for 50,4% of total, with RMB 2.291 billion. Nevertheless, the well-developed service sector is becoming more and more dynamic and relevant, producing in 2010 RMB 2.026 billion, the 44,6% share of global GDP.

The Guangdong's electronic ITC industry is the biggest in the manufacturing sector in regard to revenue and size, while the electrical household appliances production is the most important in the country in terms of export volumes for the international trade. Within the province, particular cities serve as engines of growth, shaping the geography of its industry, and encouraging the spatial agglomerations of enterprises focused on the production of products belonging to the same supply chain (Barbieri *et al.*, 2010, 2011). The most important are the capital city Guangzhou and its productive district of Foshan, the financial hub and high-tech city of Shenzhen, and the manufacturing base of Dongguan. They contribute to the prominent economic position of the Pearl River Delta, a cluster of 9 cities that concentrates half of the total population of the province (47.7 million) and 79.4% of the provincial GDP.

## 3.2 Methodology

Several studies have utilized secondary data, such as EU embassy lists or the official data of the Chinese Government as basis of their works. Although a low response rate was expected, we preferred to undertake a primary data collection directly from Italian investors in the Guangdong province in order to avoid the lack of accuracy, to address specific research issues and directly managing how the information was collected. Consequently, the primary data was collected elaborating and sending a structured questionnaire to a pre-selected sample of Italian firms operating in the Guangdong province. The questionnaire assembled 34 questions which, apart from a preliminary part on the company profile and background information, were split into two sections. Section 1 aimed at verifying the structure of Italian investments in the Guangdong province, particularly investigating the main characteristics of the initial FDI, and, even more important, the major motivations of inward Italian investments in China and in the Guangdong Province, with a particular regard to the obstacles and problems faced during the investment. Section 2 investigated the institutional investment framework perceived

<sup>4</sup> National Bureau of Statistics, China 6th Census 2010.

<sup>5</sup> Guangdong Provincial Bureau of Statistics.

<sup>6</sup> ICE (2011)

by the Italian companies in the Guangdong province, seeking to analyse the role played by bilateral agreements for the FDI protection and the developing implications for a possible future EU-China treaty on investments. The questionnaire was mainly characterised by open-ended questions or multiple-choice queries. For the questions requiring a judgement on the significance of particular aspects, a five-point Likert-type scale was used for each specific statement.

### 3.3 Sample Structure

Actually, the research attention was focused especially on Italian FDIs in this region, as a particular case study of the broader phenomenon of EU investments in China, for several reasons. First of all, Italian FDIs represent the 11,6% of the total EU FDIs in the Guangdong province in terms of foreign invested projects, being one of the largest EU investors in the region, just behind UK (28,5%), Germany (14,5%) and France (11,85%)<sup>7</sup>. Secondly, within the 25 different BITs between EU Member States and China, the Italian agreement was one of the firsts signed in 1985, at the very beginning of China's "Open door" policy toward a more liberal investment environment. As a matter of facts, the Italy-China BIT does not include several key contents for a comprehensive investment protection, such as national treatment provisions or an effective arbitration settlement concerning all substantive protections, putting Italian firms in a weaker position vis-à-vis other Member States investors. Therefore, a consolidation of a new EU BIT with China could improve the level of protection especially for Italian investors, granting the same protection enjoyed by other EU Member states companies covered by more recent and stronger BITs with China, or even improving them.

The initial sample was filtered unifying Italian Trade Commission list "Italian Companies in South China" with the China-Italy Chamber of Commerce list of members in the Guangdong Province, submitting the questionnaire to 125 firms. By the deadline given, 42 companies responded to the questionnaire, representing a statistical significant distribution of Italian firms investing in the Guangdong region in terms of sector, size and geographical distribution.

The respondent sample is characterised mainly by Italian firms who invested in the Guangdong region recently, following the trend of European firms investing in China no more than 15 years ago. From a sectoral perspective, the sample is statistically representative of Italian investments in the Guangdong province, especially regarding industry and size. Italian investments in Guangdong have concentrated mainly on secondary industries, with a share of surveyed firms operating in the Manufacturing industry, especially in electronic, IT and appliance, machinery, garment and footwear, of 61,9% (generally 56% of Italian companies in the Guangdong region operates in the manufacturing sector); the tertiary industries have become more and more important (especially business services), representing the 14,3% of the sample (19%), while the remaining 28,8% (25%) operate as trading companies<sup>8</sup>.

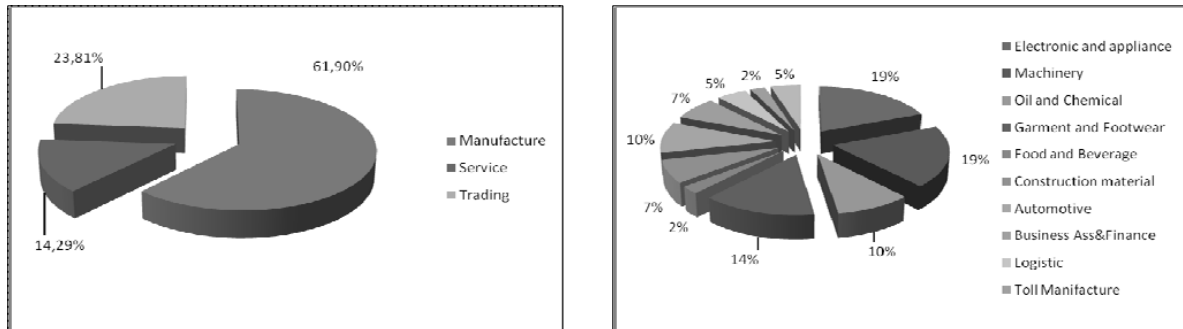
With respect to firm size, especially measured by employees, about 62% of respondents are small firms, where in this survey a firm is designated as a small one if it has less than 250 employees, considering Chinese dimensions, while 21% of respondents are categorised as medium firms (between 250 and 1000 workers) and only 16% account for more than 1000 employees.

Moreover, the sample is mostly divided among three major kinds of production: 30% of respondents produce mainly final products for market, not only for the Chinese one, but also

---

<sup>7</sup> ICE (2011)

<sup>8</sup> ICE (2010)

**Figure 1: Sectoral Italian firms distribution**

Source: Author's elaboration from primary data collection.

in order to export their products to the developed countries. A larger majority (almost 36%) produces final products for other firms, not only goods but also services, designing in this way a business to business production (B2B). Finally, the third largest category is the production of half-processed and components, representing 28% of the sample, generally in the industrial sector characterised by low-added-value productions, in order to take advantages from low labour and resources costs. In addition, the sample is representative of Italian investments in the region also from a geographical point of view, since their location is concentrated in the Pearl River Delta, especially in the cities of Guangzhou (13 firms), in its manufacturing district of Foshan (9) and in Shenzhen (9), while the remaining 8 firms are spread out across the region.

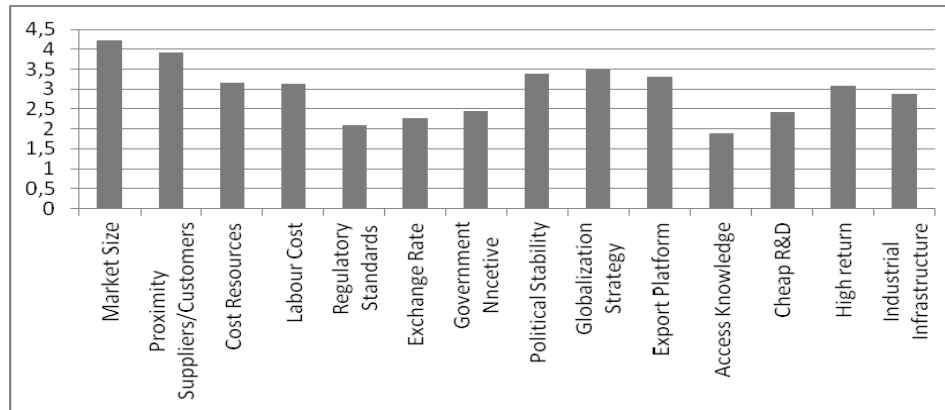
From the survey it is possible to find out also that a large majority of Italian firms investing in the Guangdong region prefers to invest in a brand new activity (greenfield investment) instead of acquire a participation in an existing company. In addition, almost 55% of the sample is categorised as a subsidiary, usually a firm controlled over 50% directly from an Italian parent company. On the contrary, only 20% of the sample is a branch, with an Italian participation between 10% and 50% of global capital, while 12% is a shareholding, characterised by less than 10% of Italian capitals. Interestingly, almost 15% of respondents are not owned by an Italian parent company, but are directly invested by Italian capitals, operating usually in the professional services sector. Moreover, it could be useful to highlight the geographical origins of these investments in China: almost 56% of Italian firms investing in the Guangdong region come from the north of Italy, especially from the Lombardia region. The remaining 41% have their headquarter in the centre of Italy, particularly in Emilia Romagna and Tuscany, while only the 3% of the respondents come from southern Italy, reflecting the typical geographical distribution of Italian multinational firms.

## 4 Findings and Discussion

### 4.1 Investment Determinants and Obstacles

One of the key aspects of this survey is certainly the study of the motivations that led Italian firms to invest first of all in China and then in the Guangdong region, and subsequently the obstacles faced during their activities in China. In order to express the significance of determinants and obstacles, a five-point Likert-type scale was used for each statement.



**Figure 2:** *Motivations of Italian Direct Investment to China Motivations*

Source: Author's elaboration from primary data collection.

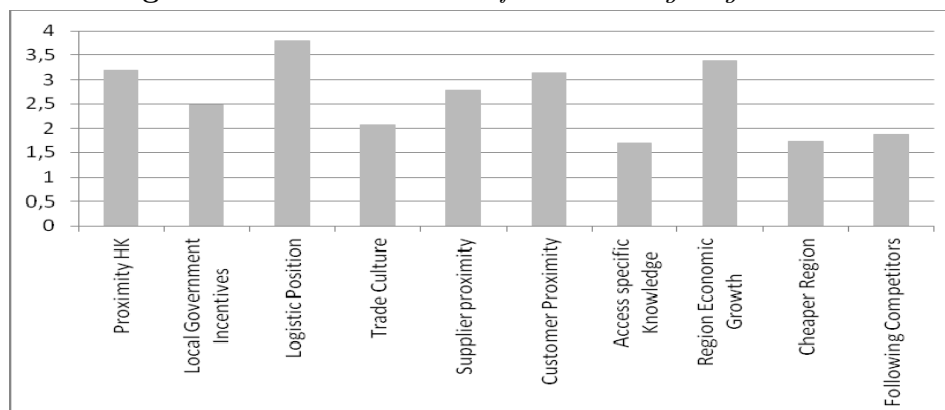
As several theoretical contributions on FDIs in China already previewed, the large majority of respondents identify the Chinese market size and its potential growth as the most important investment motivation, assigning an average preference of 4,2 on 5. Moreover, the proximity to customers or suppliers ranks second among the FDI determinants, perhaps finding out an investment structure mainly market seeking directed, and not related, as usually claimed, with the low costs of production resources. On the contrary, it is possible to notice a significant relation between cost saving FDI strategy and different investment motivations such as cheap labour costs, low regulatory standards, favourable exchange rate and Chinese Government incentive policies. Differently, on average the Italian firms recognize as quite important the motivations related to the globalization process, giving relevant grades of 3,5 and 3,4 over 5, identifying their investment to China as part of company globalization process, and using it as an export platform for other markets. The motivations related to cost saving strategies are judged significant by Italian firms only one step lower than the first two categories. However, the cheap labour and resources costs are deemed as key determinants of inward FDI in China, graded over the threshold of importance, reaching about 3,1 Likert-type points. Low labour and resources costs are still proving to be key location factors for Italian investors in China, especially in the manufacturing industry such as the automotive and electronic appliances. However, the cost saving determinants may not be sustainable in the long-run for China, facing an increasing competition from the neighbouring countries of Vietnam, Laos and India. Also for these reasons, from an institutional point of view, China's political stability is becoming more and more important as investment key determinant, which guarantees to foreign investors a predictable and stable environment for their long-run investments, as discussed before by several literature. On the contrary, the Chinese Government incentive policies seem to be less significant for Italian firms in their investment choice in China, followed by regulatory standards and exchange rate too.

Moreover, it is possible to investigate China's inward investment motivations from different sectors point of view. For instance, the investments in the service sector are mostly related to the motivation of acceding to specific technology and knowledge, particularly relevant when it is essential to adapt its product to the local market needs. As it concerns the manufacturing sector, the main FDI motivations seem to be the access to cheaper resources and labour costs, profiting from lower regulatory standards, a favourable exchange rate, Government

incentive policies, and using the branch as an export platform or to carry on cheap RD activity. This evidence finds out that Italian companies in the manufacturing industry seem not to follow the sample average, investing in China not in order to take advantages from the expanding domestic market, but looking for the best business environment possible in terms of production costs. In fact, in this way manufacturing firms can reduce their production costs, not having to support higher productive standards required elsewhere, and taking advantages from government incentives that cut off the initial costs while increasing the expected profit and the overall investment net value. Furthermore, the final goods do not seem designed and produced for the local market, in fact Italian manufacturing firms in China have a propensity to re-export their products to other markets, perhaps not only to take advantages from Chinese trade policy facilities, but also back to the EU market, where producing the same goods may require higher costs and production standards.

The analysis of the determinants of Italian inward investments in China can be further deepened through the study carried out by this survey on the motivations that led to the specific geographical location of the investment in the Guangdong Province. From the sample mean scores analysis, it is clear that only few variables are widely recognize as key factors by the Italian firms investing in the Guangdong province. Among them, the Guangdong logistic position is considered as the most important factor influencing Italian firms to invest in this region. In fact, the highly developed regional infrastructures not only offer the possibility to exploit the efficient export system to move their own goods to other foreign markets, due to its favourable location on the south-China sea, but also allow a fast movement of goods through this region, characterised by a higher economic growth in respect to the Chinese average, and a quick access to the rest of China by an extensive rail network. This evidence has also been supported by the importance accorded by the Italian firms to the customers' proximity and the region economic growth determinants. As previously discussed, the Guangdong province is the most populated and rich region of China, producing last year a regional GDP of RMB 4.547 billion, almost EUR 512,5 billion, approximately the 11,5% of national GDP, giving the importance of this region for foreign firm market seeking strategies.

**Figure 3:** *FDI Determinants for the Guangdong Province*



Source: Author's elaboration from primary data collection.

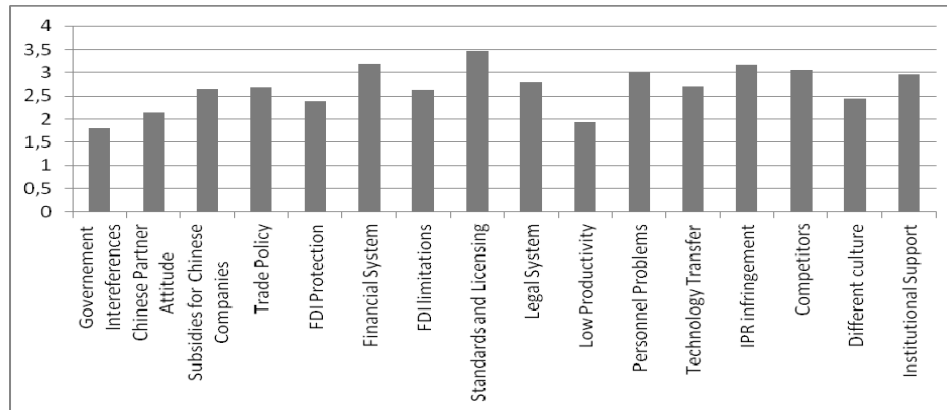
Also in this case, even though the findings seem to demonstrate the prevalence of a common market seeking strategy among the Italian firms investing in the Guangdong region, the sectoral study emphasizes different relations among the variables. First of all, it is evident a relation

between the Italian firms investing in the manufacturing industry and the importance given to some determinants of investments in the Guangdong region, such as the local Government incentives, the logistic position and the customer and supplier proximity. Regarding the service sector instead, the main determinants related with seem to be the proximity to the Hong Kong international financial centre and the Guangdong lasting trade culture. Obviously, the trading sector remains essentially based on the region logistic strategic position, considering that the Hong Kong and Guangzhou harbours are the closest ones in the maritime route to Italy and Europe. Secondly, remarkable results were found out also in relation with the typology of production and the firm FDI strategy.

For instance, the “Business-to-Business” sector follows a market seeking strategy, creating new activities in the Chinese market in order to penetrate it and to take advantages from the growing business community in China. Secondly, the main determinant of the inward investments in China is the possibility to accede to specific knowledge, probably the local business environment needs and the way to faced it. Moreover, it is evident that the principal motivation of the investments in the Guangdong region is the customer proximity, since the region is highly-industrialized and could offer a huge number of potential customers for a firm operating in the B2B sector. On the contrary, the industries producing final goods for markets tend to be more sensitive to the fluctuations of the exchange rate, and they are investing in the Guangdong principally for its logistic strategic position, highlighting in this way a strategy purely oriented to the export of “Made in China” goods to foreign markets. The analysis further proceeds studying the determinants of Italian investments in the Guangdong region and their reflections on the firm investment strategies. As a result, the Italian companies implementing in China a cost saving strategy, driven by the research of low labour and resource costs and by a favourable exchange rate, have located their investments in the Guangdong province in order to benefit from the local Government incentive schemes aimed at attract foreign capital, from its logistic strategic position and, even more important, to place the manufacturing sites close to the Guangdong suppliers, ensuring the security of supply sources. Conversely, the firms with a market seeking business strategy explained their investments in Guangdong mainly through the location determinants of proximity to Hong Kong, widening in this way their potential markets, and for the spatial proximity also with their Guangdong customers, as previously discussed, mainly other business activities. Interestingly, it appears that the Italian firms investing in China in order to carry on RD activities with cheaper costs than in Italy decide to establish their RD centre in the Guangdong region principally to accede to specific knowledge, probably related to the sophisticated business network located in it. Moreover, the investments in the province are influenced by the incentives and subsidies offered by the local Government in order to attract more and more innovative firms, creating in Guangdong a high-intensive scientific pole, which could enable the transfer of new technologies and competences to Chinese industries, pushing the development and structural transformation of Chinese productive system.

Nevertheless, the Italian firms investing in China have not experienced only benefits from their activities, but faced several times different obstacles prejudging their operations in such a difficult business environment. For this reasons, the survey investigated the main obstacles and problems faced during the investment process in China.

From Figure 4 it appears that the main obstacles are related with the political and legal environment of China. According to our respondents, the major problem concerns the heavily complicated application procedures, for instance for the licensing, the standards to fulfil in order to start the production, the registration processes and so on. Frequently foreign

**Figure 4:** FDI obstacles and problems faced in China by the Italian Firms

Source: Author's elaboration from primary data collection.

investors experience discriminatory behaviours in terms of regulatory obstacles, perceiving a preferential policy towards Chinese firms, and creating in this way hidden technical barriers to foreign investments. Particularly relevant are the discretionary enforcement of different drafted laws and regulations, the lack of coordination between different regulatory agencies and the lack of harmonisation with international standards. This kind of misconduct could lead to a slowdown in foreign investment flows to China, whether the foreign firms would be too worried about the regulatory environment. Related to this aspect, the second greatest concern for Italian companies is the continuous IPR laws infringement. Many foreign investors still consider inadequate the enforcement of IPR laws and regulations in China, having suffered significant damages from the IPR infringement and from the negative effects of the “indigenous innovation” policy<sup>9</sup>. According to the study, this aspect is particularly true for the Italian firms establishing part of their RD activity in China. Not only they experienced IPR law infringement and compulsory technological transfer, but also they perceived a sort of technical barrier to the investment, facing problems in the application for standard requirements and registrations and with the national financial and banking system. As a matter of facts, many Italian investors judge unsatisfactory the Chinese banking system not able to provide sufficient financial resources to the foreign firms operating in the country.

Particularly interesting is the sectorial analysis. The survey finds out that the manufacturing firms, as before highlighted mostly characterised by cost saving strategies to re-export their products to third markets, are particularly concerned about the unsatisfactory Chinese trade policy, which favours the domestic industry, usually creating a comparative disadvantage in terms of access to subsidies or tax incentives for the export. Moreover, the Italian manufacturing firms are more and more worried about the negative impact on their operative margins, since the growing cost of labour and of doing business in China would in the next future lower their productivity. The Italian invested service firms instead, usually characterised by a market

<sup>9</sup> A key concern for foreign investors in China with regard to public procurement as well as intellectual property is the “indigenous innovation” policy. This policy aimed at supporting Chinese firms moving up the value chain, with the requirement that foreign companies have to register their IPR in China in order to participate to several tender procedures, disclosing commercially sensitive information related to innovation and IPR. Such provisions have severely hampered the competition between Chinese and foreign owned enterprises, limiting the access for foreign investors to Chinese procurement in a wide number of innovative sectors, from green technology to telecommunications (An and Peck, 2011).

seeking strategy in particular in the professional services sector, have been affected mostly by the unsatisfactory legal system, with an unpredictable regulatory framework continuously changing as discussed above. Furthermore, overall the Italian firms investing in China are facing an increasing competition both by foreign and local competitors. The Chinese companies catch up their international counterparts in terms of product, services, technology and management, increasing the intensity of the competition. As a result, Italian firms are more aware and sensitive to changes in the regulatory landscape that may affect them, and for these reasons they have expressed their concerns about the lack of institutional support that may inform and help them in their business activities in China. For the moment the Chinese Government interference and the FDI protection and limitation policies are not listed among the most worrying concerns, even if in the future there will be a growing claim for institutional support from the Italian and European firms facing growing adversities in China.

## 4.2 Implications for the future EU-China Investment Agreement

The final part of the survey is dedicated to the study of the impact on Italian firms investing in the Guangdong of the changing institutional investment framework. Primarily, the questionnaire asked about the effective utilisation of the existing Bilateral Investment Treaty tools, which are part of the instruments that the EU investment policy should reshape in future with China. In fact, the final aim of this survey is to better understand the probable implications of an EU-China BIT for Italian firms operations in their investment activities in China, in order to offer some proposals in terms of policy options for the EU investment policy.

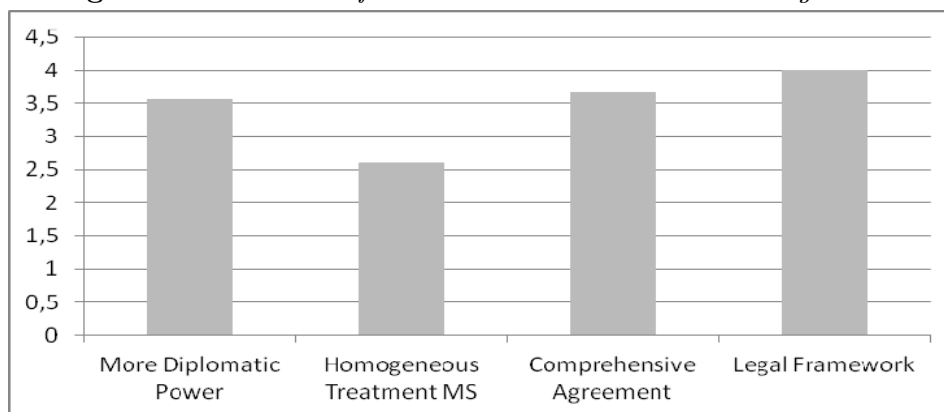
Among the 42 respondents to the questionnaire, only 5 Italian firms admit that they have used some provisions under the China-Italy bilateral investment agreement in order to defend their rights as foreign investors, usually for the most sensitive and important cases. The larger part have used the set of rules provided by the bilateral agreements in the event of expropriation of physical assets or the seizure of intangible assets, such as shareholder participations, while two Italian firms required the intervention of BIT standards in order to avoid double taxation or to ensure a reasonable level of royalties to be paid. On the contrary, the vast majority of Italian firms (almost 50% of them) usually apply for local proceedings in dealing with eventual legal conflicts in China. Since the Italian firms applying for the BIT provisions are mainly characterised by a long period of business presence in the Chinese market and by large scale of the Italian parent companies, the lack of utilisation of BIT provisions could be linked mainly to the necessity of critical negotiating weight and particular management skills in order to carry on such complicated procedures. Only these kinds of firms can properly protect their subsidiaries in China, laying down a more mature understanding of Chinese business environment and a greater lobbying power. For these reasons, it may be easier for an Italian firm to apply for a dispute settlement provided directly by the EU-China investment agreement. This kind of apparatus could be even more useful if it includes the possibility to carry on a legal dispute between European firms and the People Republic of China, enabling all companies, even the smaller ones, to defend their investor rights against Chinese Government actions, making even safer and fairer the legal framework for foreign investments. The 62% of respondents strongly support the inclusion of such proceedings under the framework of the EU-China investment agreement, particularly required by those firms who have faced FDI obstacles and problems related to unfair competition due to public subsidies enjoyed by Chinese companies or to unsatisfactory Chinese trade policy that damaged the firm business.

The survey analysed then the main motivations for a new EU-China investment agreement

in the framework of the Common Investment Policy according to the Italian firms investing in the Guangdong province.

Italian investors consider almost all the reasons as quite important. The respondents are particularly interested in the EU-China investment agreement mainly because thanks to a new treaty it should be possible to set up a fairer, non-discriminatory and predictable legal framework for foreign investment, in confront with the one enjoyed nowadays.

**Figure 5:** *Motivations for a new EU-China Investment Agreement*



Source: Author's elaboration from primary data collection.

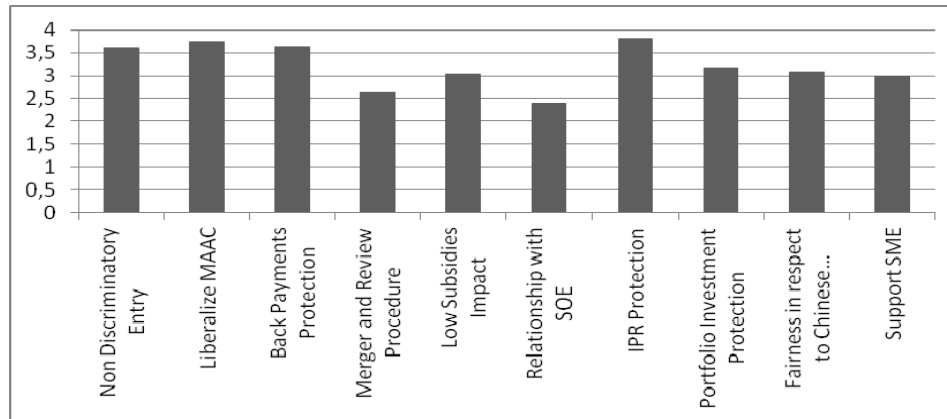
As discussed above, the legal and procedural framework still remains a great concern for Italian investors in China, apparently not sufficiently addressed by existing agreements. The EU should urge the Chinese Government to make changes to the regulatory and standard systems following international standards guidelines. In addition, to enhance transparency, several measures could be included in the investment agreement provisions, such as to make public the FDI approval process or to implement the information activity concerning foreign investment requirements (OECD, 2003). European investors ask to receive a treatment no less favourable than the one accorded to the Chinese companies engaged in similar business activity, in other words a national treatment. Thus, the EC should require the competitive neutrality of public policies in order to create a level playing field for both Chinese and European industries, ensuring the transparency and comparability of legislation and regulations, further enhancing competition policy combining the various fragmentary and dispersed policy initiatives, perhaps increasing the scope of stakeholder consultation with regard of FDI-related legislation (OECD, 2003). Secondly, the industries require the intervention of the EU to negotiate a more complete and comprehensive agreement, including new provisions not yet handled by member states treaties, as the survey will study below. Interestingly, the motivation of an homogeneous treatment among investors from different EU member states seems to be not particularly relevant for Italian investors, except for the Italian invested firms that did not have an Italian headquarter, which probably deficit from a corporation powerful protection from Italy. Finally, the negotiations carried on by the EU should improve the general conditions of existing bilateral treaties thanks to a greater diplomatic power, unifying the various EU member state voices in requiring new concessions in investment issues.

Since the Italian firms deem necessary to negotiate an investment agreement at the European level with China in order to obtain a more complete and comprehensive agreement, the survey asked to the sample which are the most important topics that a future investment treaty has



to include.

**Figure 6:** *Most important topics for a future EU-China Investment Agreement*



Source: Author's elaboration from primary data collection.

According to the respondents, the most important topic for the future agreement is to provide a better protection for firm's key technologies and intellectual property rights. Such a matter is still perceived by the European business community as a fundamental topic to tackle in order to improve the attractiveness of China as a host economy for foreign investments. The more competitive the Chinese economic environment will become, the more important will be for Italian and European firms to protect their intangible assets, which allow them to maintain a comparative advantage. Another key aspect for Italian investors is the pre-establishment phase in China. From the survey clearly appears that many firms deem indispensable to set up, throughout an EU-China agreement, a fair and non-discriminatory legal framework governing the foreign investment entry. In fact, also the subsidies enjoyed by Chinese firms are considered as a barrier for the foreign investment entry, becoming a major issue to be addressed during the negotiations. This evidence is further corroborated by the high proportion of significance scored by the "market access" issue, since many Italian firms still claim for the liberalization of market access for foreign investments in some key sectors still closed or only partially available. The back payments related to the venture and the portfolio investments are particular interesting topics for the Italian firms too. Apparently, there is a real need for the Italian and European firms to assure the transfer of their investment income out of the jurisdiction of the host country, the repatriation of their capitals back at the end of the investment as well as their portfolio investments too (Muchlinski, 2007). For this reason, the EU should take the appropriate steps to negotiate a comprehensive agreement with China, protecting even the indirect investments with the participation of EU Member States, being the matter a shared competence.

Giving the growing number of small and medium Italian firms operating in China, there is a growing interest among the investors for a better protection and support of SMEs, even granted by a bilateral agreement on investments. This issue could be tackle also indirectly thanks to different other provisions, such as setting up a fair and non-discriminatory legal framework, or providing an easier access for those firms to the legal assistance and to financial resources, contingent troubles that often strangle small business ventures.

From a cross-sectors analysis, it is possible to notice that principally large firms following cost saving strategies are particularly interested in an EU-China investment agreement able to

better regulate the relationship with Chinese State owned firms, for instance enabling foreign companies to invest in them or to guarantee a fair competition not hampered by Chinese authorities interferences. Moreover, these kind of firms, characterised by costs saving business plan, particularly suffer from the competition of Chinese firms in outlet markets, producing the same range of products, and therefore they ask for an agreement able to provide in China a fair business environment in respect to that enjoyed by Chinese firms investing in the EU.

On the other hand, the Italian firms investing in China in order to take advantages from its incredibly increasing market seem to be more interested by other provisions that the EU investment policy could provide. For instance, better regulating the relations with the Chinese state owned firms, the Italian firms would experience a fairer competition in the Chinese market. Moreover, the market seeking firms would like to protect their portfolio investments, since usually shareholding participation is preferred initially to penetrate a new market instead of build up a new greenfield project. As discussed before, the Italian firms with a market seeking strategy are usually present in the service sector, particularly providing professional services, and are characterised by small size in terms of employees. For these reasons, the market seeking firms tend to ask for an agreement able to better protect and support SMEs investments in China, often pressed by large multinational firms' competition. In addition, some findings show that the more the Italian firms are large-sized in terms of employees and income, the less they are interested in the development of a new EU investment policy towards China. This is due probably to the fact that big firms have more weight in negotiating and dealing with operational problems faced in the Chinese business environment. For these reasons, the future EU-China investment agreement has to mainly take into account the requests moved from the small and medium-sized firms, more dependent on the institutional support.

Finally, the questionnaire concluded asking to the Italian firms which issues not directly related to the foreign investments might require specific attention and could be improved by the future EU-China investment agreement. In fact, the Treaty of Lisbon enumerates several general principles to be followed by the EU external actions, and so for the Common Investment Policy, including the promotion of democracy, the rule of law, the respect of human rights and the contribution to a sustainable economic, social and environmental development of emerging countries. According to the Italian investors, the most important topic not directly related to investments to be tackled in the future EU agreement with China is the environment safeguard in China. Nowadays the Chinese government has made many steps forward to defend the environment and solve the long-lasting problem of pollution in the big industrial cities. Despite, according to the Italian firms, a lot of actions still remain to be done in this field, in particular regarding the application of international environmental standards and the ratification of international agreements. Moreover, the Italian investors also consider as a relevant issue the labour conditions of Chinese workers, since still remain many ILO conventions to be ratified by China, and the development of human rights, a controversial topic difficult to handle with Chinese authorities.

## 5 Conclusions and Policy Implications

This study focused its attention on the impact of the EU changing relations with China on the Italian firms investing in the Guangdong region, particularly in the investment sphere. Two main aspects related between them were discussed and investigated. First of all, the main determinants and obstacles of Foreign Direct Investments in China were examined. This

kind of work enabled us to specify a reasonable model for the determinants of investment as a basis for understanding the implications for a probable BIT between EU and China. Finally, the behaviours and the difficulties faced by Italian firms in the investment process in the Guangdong region were deeply analysed, with particular regard to the role played by bilateral agreements for the FDI protection and to the development and the impact of a possible future EU-China treaty on investments. These concluding remarks do not intend to summarize all of the above mentioned aspects. Instead, these final comments will be concentrated on the analysis of the policy implications for some central findings of this study, especially from the perspective of the impact of a future EU-China investment agreement on firms' behaviour.

Despite several literature finds out little evidence of a connection between BITs and growing FDI flows, industries have shown a particular interest in the development of EU-China relations on investments. According to the findings, a comprehensive investment agreement between the EU and China could finally offer the opportunity to create a single framework applicable to all investors from the 27 EU Member States, covering both investment liberalisation through new markets access and an uniform standard of protection, helping the European companies to address their needs in an increasingly competitive Chinese investment environment. The EU should focus its attention on few specific topics, in order to tackle the most valuable and deliverable issues for the European industries.

Particularly, the EU has to grant top priority at the pre-establishment phase in respect to investment protection. As largely requested by the Italian industries surveyed, the EU has to push in order to obtain a better market access for its investments in China. In particular, the EU action should be focused on China's most protected sectors, namely the service industry, prioritizing the liberalization of Chinese services particularly attractive for European firms. In fact, the EU economy will be more and more services-oriented in the next future, enjoying in this way from a strong comparative advantage in comparison with Chinese competitors.

Moreover, there is a growing concern about the Chinese investment regulations, which still remain the "Achilles' heel" of China's economy. The EU should urge the Chinese Government to make changes to the regulatory and standard systems, following mainly the international standards guidelines, and including provisions that assure the competitive neutrality of public policies in order to create a level playing field. Moreover, it would be good practice to ensure the transparency and comparability of legislation and regulations, further enhancing competition policy combining the various fragmentary and dispersed policy initiatives.

Another key area for the investment agreement intervention should be the protection of intellectual property rights. As demonstrated by the survey, European industries in China are trying to build local brands and marketing capabilities, improving the product quality and developing new innovation technologies in order to enhance their comparative advantages in the Chinese market. This could be possible only if the innovating and promoting processes, and the related investments, will be successfully protected and granted by specific Government measures. A better way of addressing IPR issues would be useful also for China and would enable the country to attract more long-term and high-quality FDI from developed countries.

Finally, the EU should promote, within and outside the future EU-China investment agreement framework, the development of small and medium firm investments and presence in China. We have noticed in the empirical research that small and medium Italian firms in China are usually concentrated in the growing service sector, industry that a future EU-China investment agreement would further open to the European investors. Thus, a future agreement must protect even more the small and medium firms, considering that they usually operate in the most innovative and turbulent markets.

To conclude, China is more than a rising economic power, it is a leading and changing country. Undoubtedly, the potential of China as a political and economic player in the world stage is just rising, and it is already clear that China's integration into the world economy will not be painless. Although among the literature there is no significant empirical evidence of the effective role of BITs in promoting FDI flows, this survey demonstrated how industries and policy-makers deem necessary the implementation of international legal binding acts for the development of long-lasting investments, in order to foster a mutual economic development and social welfare. European policy-makers could drive several benefits for the EU's economy by finally launching firmly its brand new Common Investment Policy with China, in the framework of a long-lasting and bilaterally beneficial relationship for the next future.

## References

- Aisbett, E. (2009). Bilateral investment treaties and foreign direct investment: correlation versus causation. In K. Sauvart and L. Sachs, editors, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*. Oxford University Press, New York.
- An, S. and Peck, B. (2011). China's indigenous innovation policy in the context of its WTO obligations and commitments. *Georgetown Journal of International Law*, **42**(2), 375–448.
- Barba Navaretti, G. and Venables, A. (2004). *Multinational Firms in the World Economy*. Princeton University Press.
- Barbieri, E., Di Tommaso, M. R., and Huang, M. (2010). Industrial Development Policy and Innovation in Southern China: Government Targets and Firms' Behaviour. , *European Planning Studies*, **18**(1), 83–105.
- Barbieri, E., Di Tommaso, M. R., and Bonnini, S. (2011). Industrial development policies and performances in Southern China: Beyond the specialised industrial cluster program. *China Economic Review*, page doi:10.1016/j.chieco.2010.12.005.
- Bergstrand, J. H. and Egger, P. (2012). What Determines BITs? CESifo Working Paper Series No 3514 available at SSRN: <http://ssrn.com/abstract=1888170>.
- Daude, C. and Stein, E. (2001). Institutions, Integration, and the Location of Foreign Direct Investment. *Inter-American Development Bank, Washington DC*.
- Dollar, D. and Kraay, A. (2002). Institutions, Trade and Growth. *Paper prepared for the Carnegie Rochester Conference on Public Policy*.
- Egger, P. and Pfaffermayr, M. (2004). The Impact of Bilateral Investment Treaties on Foreign Direct Investment,. *Journal of Comparative Economics*, **32**(4), 788–804.
- Enright, M., Scott, E., and Chang, K. (2005). *Regional Powerhouse: the Greater Pearl River Delta and the rise of China*. John Wiley & Sons (Asia) Inc., Singapore.
- Ginsburg, T. (2005). International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance. *International Review of Law and Economics*, **25**(1), 107–123.
- Guerin, S. (2010). Do the European Union's Bilateral Investment Treaties matter? The way forward after Lisbon. *CEPS Working Document*, No. 333/July 2010, CEPS.
- Hallward-Driemeier, M. (2003). Do Bilateral Investment Treaties Attract FDI? Only a Bit and They Could Bite. *Policy Research Working Paper Series*, No. 3121, The World Bank, Washington D.C.
- ICE (2010). Italian Companies in South China. *ICE Guangzhou Office, China*.
- ICE (2011). Cina: profilo economico della provincia del Guangdong. *ICE Guangzhou Office, China*.

- Kleinheisterkamp, J. and Woolcock, S. (2010). The EU Approach to International Investment Policy After the Lisbon Treaty. *European Parliament INTA Committee*, Directorate-General for External Policies - Policy Department, Brussels.
- Messerlin, P. (2010). The European Community Commercial Policy. *SciencesPo Groupe d'Economie Mondiale Working Paper*, June 2010, Paris.
- Muchlinski, P. (2007). The Framework of Investment Protection: The Content of BITs. Derived from P. Muchlinski (2007), *Multinational Enterprises and the Law*, Oxford University Press, Oxford. Reprinted as chapter 2 in L. Sachs, K. P. Sauvant (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*, Oxford University Press, Oxford.
- Neumayer, E. and Spess, L. (2005). Do Bilateral Investment Treaties increase foreign direct investment to developing countries? *World Development, Elsevier*, **33**(10), 1567–1585.
- OECD (2003). OECD Investment Policy Reviews - CHINA: Progress and Reform Challenges. OECD Publishing, Paris.
- OECD (2010). OECD Territorial Reviews: Guangdong, China 2010. OECD Publishing, Paris.
- Poulsen, S. (2010). The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence. In K. Sauvant, editor, *Yearbook on International Investment Law and Policy 2009/2010*. Oxford University Press, New York.
- Rodrik, D., Subramanian, A., and Trebbi, F. (2002). Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development. *NBER Working Paper*, no. 9305.
- Rose-Ackerman, S. and Tobin, J. (2005). Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties. *Center for Law, Economics and Public Policy Research Paper* no. 293, Yale Law School.
- Sachs, L. and Sauvant, P. (2009). *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*. Oxford University Press, Oxford.
- UNCTAD (1999). Trends in International Investment Agreements: an Overview. *UNITED NATIONS Publication*, Geneva and New York.
- UNCTAD (2007). Bilateral Investment Treaties: 1995- 2006. United Nations, New York.



# Gli IDE Italiani in Cina: analisi ed implicazioni per la nuova politica UE sugli investimenti

E. Vanino, Università degli Studi di Padova

## Sommario

Nel 2009 il Trattato di Lisbona ha ampliato le competenze dell'UE creando una politica comune sugli IDE. La Cina è stata definita dalla Commissione Europea come un perfetto candidato per un futuro accordo bilaterale. Questa ricerca vuole indagare l'impatto dell'evoluzione delle relazioni UE-Cina sul comportamento d'investimento delle imprese Europee. Dopo un esame dei contributi teorici sugli effetti dei BIT, sarà analizzato un modello delle motivazioni degli IDE Europei in Cina, sulla base dei dati derivanti dagli IDE italiani nella regione del Guangdong, esaminando qualora un accordo UE-Cina possa aiutare gli investitori Europei ad affrontare le loro crescenti esigenze.

**Classificazione JEL:** *F21; F23; F53*

**Parole Chiave:** *IDE; Politica UE investimenti; Cina; Guangdong; Investimenti Italiani; BIT.*